# The Canadian Chartered Accountant



## THE TAX REVIEW

THE CANADIAN INSTITUTE OF CHARTERED ACCOUNTANTS

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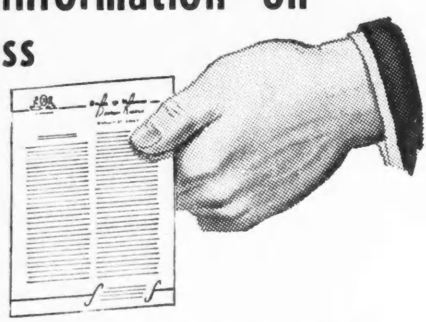

# The Canadian Chartered Accountant

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## THE TAX REVIEW



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# SWEETNESS and LIGHT

*By Jay Vee*

## Mixed Grill

SINCE we have just moved to our new offices and are still in the process of getting settled, we must invite our readers to a sort of pot-luck meal with us in this month's column.

As an appetizer we would offer some choice morsels which one who signs himself "Course Instructor" has sent in. These little gems, he tells us, were taken from solutions to the Fifth Year Lessons:

1. "Sales invoices should be numerically numbered."
2. "Employees must either punch a time clock at the gate, or a time-keeper engaged for that purpose."
3. "A danger of fraud or error that should be avoided is having horses on the payroll."

"Course Instructor" hopes that junior readers in particular will relish these and remember them next time a senior student hauls them over the coals for dubious usage of English.

Maybe, however, as far as the seniors are concerned the appetizer tastes rather flat. If so, let them regard this letter from New Zealand which appeared in *The Accountant's Journal*, February 1, 1954 as a little Worcester sauce:

*New Plymouth, N.Z.*

Sir: In the past the *Journal* has published howlers from examination papers.

## Sweetness and Light

Apparently students are not the only culprits, as this advertisement taken from *The Dominion* of January 11, 1954 will disclose. The advertisers are a leading firm of public accountants:

> "Applicant must be a member of the N. Z. Society of Accountants, and a knowledge of auditing will be an advantage although this qualification is not essential."

M. J. JAMES

And now for the main course, designed to appeal to the overworked and underfed practitioner, we have a poem by "A Martyred Accountant" from the March 27, 1954 issue of *The Accountant*, the well known English accounting publication:

"Mr. Chairman", I said, "an auditor's bread
Is his primary need, I agree,
But how grateful I am for the portion of jam
That makes a respectable fee!

"We managed to thrive in the year 'forty-five
On the figure you fixed for the audit,

And I'd not ask the board for further reward
If the company couldn't afford it;

"But having raised off its remarkable profits
Reserves it will never require,
It is not on the rocks — and to muzzle the ox
Is a course that you cannot admire."

* * *

"My board shall discuss your request. But don't fuss",
The Chairman replied, "if you find
That the portion's minute, and the traces of fruit
Are all of the raspberry kind."

It looks as though those last two lines have taken care of the dessert as well, and now if the ladies would care to join us for coffee amid the stationery supplies, we will leave the gentlemen to discuss telephone outlets over their cigars and liqueurs.*

*'Taint true! — ED.

The Canadian Chartered Accountant

VOLUME 64 JUNE, 1954 NUMBER 6

## COMMENT AND OPINION

### Ontario Institute's New Building

ON the evening of April 29 the personnel of the Ontario Institute and of the C.I.C.A. left their respective offices a little later than usual, and as the portals closed behind them for the last time a few of them (the sentimental ones) looked back a little wistfully. To all of them 10 Adelaide Street East had been their week-day home for the entire duration of their employment with the respective Institutes, and it had been the home of the two Institutes long before the first of the present personnel entered the great bronze door on the ground floor for the first time. Nowadays hardly anyone stays for long in the same place but, even so, one cannot suppress a feeling of nostalgia at leaving the day-time home which has become so familiar and in which so much has happened over the years, even though, like Sidney Carton, it may be a far far better place he goes to.

On the following day, which being April 30 has particular significance to most members of the accounting profession, the Ontario Institute and the C.I.C.A. took possession of their new premises in the Ontario Institute's handsome new building at 69 Bloor Street East, designated "The Chartered Accountants' Building". The Ontario Institute occupies somewhat more than half of the main floor and the C.I.C.A. about an equal area of the second floor, the remainder of the space being leased out to other organizations. Our own editorial offices are at the southwest corner of the second floor, and our personal sanctum is to be blessed by both the southern and western sky. The executive secretary of the C.I.C.A., who is ensconced in the north-west corner, has, by an unkind fate, been totally debarred from a view to the west by the protruding electric sign of a moving picture theatre. What is more, the sign, which advertises the various cinematographic productions on display inside the theatre, not only employs lights of variegated colours but, we fear, it is one of those signs which flashes on and off. Visitors to Mr King who come late will therefore have the pleasure of conducting their conversation in the cheerful glare of the rainbow's colours — one after the other.

### Scottish Institute's Centenary

CANADA'S chartered accountants will be officially represented at the centenary of the founding of the profession in Scotland by Mr Walter J. Macdonald, president of the C.I.C.A., himself a native of Scotland, and Mr E. J. Howson, F.C.A., a past president of the C.I.C.A., as well as by representatives of several provincial Institutes. The celebration of the grant of the first charter to the Society of Accountants in Edinburgh is to take place in the Scottish capital June 16 to June 18. The profession in Can-

ada — and the same can probably be said of almost every country in which English is spoken — owes an immeasurable debt to the Scottish chartered accountants and to the various Scottish societies of accountants, now joined into one. Recently, indeed, we encountered a chartered accountant in New Brunswick who, though an Englishman born and bred, was nonetheless a member of the Scottish Institute in spite of the fact that he had never been in Scotland in his life. It was Sir Winston Churchill, we think, who said that the only trouble with Scotsmen was that there weren't enough of them. Apparently Scottish chartered accountants have found a way to remedy even that failing.

*The Canadian Chartered Accountant* joins with the rest of the accounting world in extending to the Scottish Institute heartiest congratulations on completing its first hundred years and will look forward to expressing a similar thought in its June 2054 number.

### The Demise of Reg. 1100(4)

PROBABLY no one witnessed with greater satisfaction than accountants the removal from the scene of Income Tax Regulation 1100(4), which linked the capital cost allowances of corporations to their books and accounts and, in conjunction with the statutory rates and the other rules, distorted, sometimes seriously, income reporting. The removal of reg. 1100(4) will, however, bring to the fore another problem. Glancing through the April 1954 number of *The Journal of Accountancy* we happened on "Letters to the Editor", and what do you suppose was the heading to the very first letter on the page?

*"Deferred Taxes Are Not Forgiven: Not Reporting Them is Misleading".*

### The Quebec Income Tax Act

ALTHOUGH *The Canadian Chartered Accountant* does not express any view on controversial political questions — and certainly Quebec's new personal income tax legislation falls within that description — our readers will not, we are sure, desire us to ignore all notice of a measure which will affect them in their professional capacity — and undoubtedly the new Quebec statute fits that description. Those of our *confrères* resident in Quebec will not only have to take cognizance of the new statute in their professional practice, they will have to do so in their personal capacity as well. So also, it appears, will many chartered accountants who are not resident in Quebec but who possess clients carrying on business there and also chartered accountants not resident in Quebec who are members of accounting firms which have offices in Quebec. The Quebec legislation follows the Dominion Income Tax Act in requiring employers, wherever resident, to deduct the Quebec tax on wages and salaries at the source, and though we understand that the fiscal legislation of one Province is not enforceable in another Province the Quebec legislation can undoubtedly be enforced in Quebec where the non-resident client is carrying on business. Members of accounting firms which possess offices in Quebec, though themselves not resident in Quebec, appear to be taxable under the Quebec statute on the portion of their professional income reasonably attributable to the business carried on by their firms in Quebec, and, what is more, there seems to be some question under the terms of the Quebec legislation whether they are entitled to any part of the personal and marital allowances which are accorded to residents of the Province.

# Outline of a Plan For Profit-Sharing

By Douglas D. Irwin, B.A., C.A.

**The principles and mechanics of successful profit-sharing plans**

PLANS for the sharing of corporate profits with employees are intended to promote the economic achievement and morale of an organization and its employees. The two purposes provide mutual support and one cannot be easily attained without the other. Therefore, any successful plan of profit-sharing must stress sound financial planning and sound psychology.

While to increase corporate profits may be the main aim of investors and management, the importance of imparting to the employee a sense of participation in the success of the enterprise cannot be too strongly emphasized. The end result of profit-sharing should be greater *esprit de corps* among all employees, and this will most assuredly be achieved if the individual employee is able to understand clearly the way in which he shares in the general prosperity of the organization.

Experience in many actual schemes of profit-sharing shows that management must start with an earnest desire to improve the economic condition and general welfare of the employees rather than with the main purpose of securing greater earnings. By so doing, a partnership of capital, management, and working force may be created. As in the case of a legal partnership the beneficial results of the partnership contract should be shared on a basis which recognizes the respective contribution of each member.

It is important that the terms of any profit-sharing plan be explicitly stated and rigidly observed. Insofar as possible the operation of the plan once established should be removed from direct influence by the management. In this way the employees will feel a sense of importance, independence, and security which cannot be achieved if their share of profits, however large, is looked upon as an arbitrary and wilful gift.

Further principles and the general mechanics of any plan for profit-sharing are best illustrated by a hypothetical case. For this purpose let us suppose that a profit-sharing plan is to be set up for a sales organization, with a staff of 80 people classified as follows:

| | *Staff* |
|---|---|
| 1. Executives | 2 |
| 2. Direct outside sales | 12 |
| 3. Indirect and administrative sales | 18 |
| 4. Accounting and traffic control | 14 |
| 5. Stenographic and office personnel | 14 |
| 6. Warehouse personnel | 20 |
| | 80 |

We shall assume that capital employed in the business is $1,250,000, this being the amount of paid-in capital stock together with accumulated profits as shown by the last balance sheet of the company. We shall also assume that operating profits before income taxes and any deduction for profit-sharing, but after all charges for operating expenses, bad debts, depreciation, etc., are approximately $400,000 per annum.

The following factors should be considered in determining the distribution of profit:

1. Profits should be the normal business profits after all ordinary charges allowed for income tax purposes, but before the charges for employees' profit participation and income taxes.
2. An allowance should be made for a fair rate of return on the amount of capital employed in the business.
3. A formula for the calculation of the share of profits to be paid to the employees should be determined.
4. Participation by management in profits.
5. A system of evaluating the individual employee's share of the profit pool.
6. Arrangements for the creation, administration, allocation, and distribution of the employees' profit pool.
7. Considerations of income taxation.
8. Actual cost to employer.

### Fair Return on Capital Employed

One principle of profit-sharing is that employees should be paid a basic remuneration at or above market levels for each job classification before profit participation is taken into account.

Similarly an appropriate return on capital, at least equal to the market level of a return on investment in the same or a similar line of business, should be payable to the shareholders before determining the amount of profit to be shared with the employees.

A rate of from 5% to 15% might be adopted as a fair return on the amount of capital employed, having regard to the nature of the company's business and particularly the risks involved. It might be correct to adopt a rate of 15% if the business is of a speculative nature selling new products, exploring new fields, etc. On the other hand, if it is a well-established business selling, on a conservative basis, products for which a good market has been developed, a fair rate of interest on capital invested might be 6% to 8%. However, the employees of profit sharing companies would receive at least as high as, and preferably better than, average remuneration, and the shareholders would thereby incur a somewhat greater risk under a profit-sharing plan than would otherwise be the case. Any losses which may be sustained fall wholly on the shareholders. It would be unwise and impracticable to expect the employees to bear part of them even though losses will be greater to the extent that employees' wages are better than average. A special risk-taking reward may properly be given to the shareholders to insure against this special risk. In the following computations, therefore, a rate of return to shareholders of 8% has been used.

In rewarding the investors in our hypothetical enterprise we first reserve 8% of $1,250,000 ($100,000) and deduct this amount from the operating profits. The shareholders thus will receive the benefit of an appropriate interest allowance, plus a substantial share of the remaining profits.

The remaining profits will then be divided between shareholders and employees on some appropriate basis. The basis should, of course, recognize that corporate taxes must be paid out of the shareholders' gross share. The formula

for distribution will, therefore, reflect a result which relates the shareholders' net share, rather than the gross share, with the employees' share.

### Distribution of Profits to Employees

After providing for a fair rate of return upon capital employed we divide the balance of the profits so that the employees' profit share is equal to the final net earnings after corporate income taxes. Both capital and working force, having first received a fair basic return for their respective contributions, will now share equally the remaining profits. Furthermore, as both employees and investors are subject to personal income taxes upon eventual distribution, an allocation of this sort will create the conditions of fair and equal partnership.

Changes in corporate income tax rates will not affect the exact calculations in any year as such taxes will form part of an algebraic equation illustrated as follows:

1. Return on capital = 8% of \$1,250,000 = \$100,000
2. Profits = \$400,000
3. Net earnings after taxes = Shareholders' shares of profits = X
4. Employees' share = Y = X — \$100,000
5. Corporate income taxes = 20% on \$20,000 = \$4,000
   and
   49% on remainder of taxable profit
6. Taxable profit = \$400,000 — (Y) or (X — \$100,000)

**Equation:**

$$x = (\text{Profits} - \text{Employees' share}) - \text{Taxes}$$

$$x = \$400{,}000 - (x - \$100{,}000) - \left(\frac{20}{100} \times (\$20{,}000) + \frac{49}{100}\left(\$400{,}000 - \$20{,}000 - (x - \$100{,}000)\right)\right)$$

$$x = \$500{,}000 - x - \$4{,}000 - \frac{49}{100}(\$480{,}000 - x)$$

$$100x = \$50{,}000{,}000 - 100x - \$400{,}000 - \$23{,}520{,}000 + 49x$$

$$151x = \$26{,}080{,}000$$

$$x = \$172{,}715.23$$

$$y = x - \$100{,}000$$

$$y = \$172{,}715.23 - \$100{,}000$$

$$y = \$72{,}715.23$$

**Proof:**

| | | |
|---|---|---|
| Profits | | \$400,000.00 |
| *Less* | | |
| Employees' profit share | | 72,715.23 |
| Taxable profit | | \$327,284.77 |
| *Less* | | |
| Income taxes on \$ 20,000.00 | \$ 4,000.00 | |
| on \$307,284.77 | 150,569.54 | 154,569.54 |
| Net earnings available to shareholders | | \$172,715.23 |
| Consisting of: | | |
| Return on capital employed | \$100,000.00 | |
| Profits' share equal to employees' share above | 72,715.23 | \$172,715.23 |

The net earnings accruing to shareholders consist of $100,000, which is a fair return on capital, plus $72,715.23, which is a share of profit equal to the share payable to employees.

The equal distribution of profits may be more explicitly shown as follows:

| | |
|---|---|
| Profits subject to distribution | $400,000.00 |
| *Deduct* | |
| Fair return on capital employed | 100,000.00 |
| | $300,000.00 |
| *Less* | |
| Federal income taxes | 154,569.54 |
| Net profits for distribution | $145,430.46 |
| Whereof: | |
| To employees 50% | $ 72,715.23 |
| To shareholders 50% | 72,715.23 |
| | $145,430.46 |

Having thus determined the arithmetical method of arriving at the total of the employees' share of profits, we turn to an examination of the principles and mechanics of allocating this share to the individual participants.

### Management's Participation in Profits

The executives of the organization occupy a unique position as employees. Through imagination, initiative, and the exercise of control functions they make a more obvious contribution to the success of the enterprise than other individual employees and should receive a reward distinguished in method of determination from that used for all other employees. It is therefore proposed that management should receive 50% of the employees' share of profits. In this illustration, this would be 50% of $72,715.23, or $36,357.61.

The sum of $36,357.61 would then be divided among the executive officers on an equal or on some other equitable basis according to their respective contributions to the enterprise.

### Evaluation of Individual Employee's Share of Profits

Profit-sharing is not a substitute for adequate basic remuneration. Almost all successful profit-sharing plans are found in organizations where the basic wages or salaries are at least equal to, and often exceed, the market level for each classification of employee. Basic remuneration should compensate the employee fully for his unique service and take into account his training, experience, responsibility, position and, to a certain extent, his length of service.

The employee's share of the profit is intended to represent his portion of the beneficial effect of the team effort. It seems fair to assume that to a very large extent his participation in the profit plan will be gauged by the factors which determined his basic remuneration. This is a practical guide and permits management to limit the additional factors governing the employee's participation in the profit plan to an evaluation of special reward for outstanding service, long service, loyalty, and effort.

While there are a great many variations and combinations in different plans, I suggest, for simplicity, that the share of each employee in the profit pool should be based on an award of points as follows:

**Basis**

1. Basic remuneration: 1 point for each $10.00 of annual remuneration.
2. Length of service: An increment of 2% for each year of service with a maximum of 40% calculated on basic points.
3. Special service: Expressed as a % of basic points.

The points for basic remuneration and length of service are self-explanatory, but the basis of awarding points for

special service is not so easily defined. The principle generally followed is that there must be no confusion in the determination of points. Insofar as possible no arbitrary or undefined influence should detract from the fairness of the scheme. However, there may be cases of especially meritorious service which the employees themselves would recognize as deserving of additional consideration.

Management may reward a continuous merit through promotion and/or higher basic remuneration which will be reflected automatically in higher points for profit-sharing. Valuable suggestions made for the benefit of the organization as a whole, winning of competitions, exceeding of sales quotas, achievement of cost savings, and acts beyond the call of duty should be rewarded in the year in which they took place. An award of extra points might be calculated as a percentage of basic points or given in absolute amounts. A committee consisting of two or more employee representatives and one executive might be appointed to evaluate these special awards. As these constitute the only extraordinary incentive to special effort a good deal of publicity should be given to the awards made.

**Douglas D. Irwin, B.A., C.A. graduated from the University of Manitoba in 1938 and held the Alexander MacKenzie Fellowship in Economics at the University of Toronto. Discharged from the Army with the rank of captain, he received his C.A. in 1947. He is now with Fred Page Higgins & Co., Toronto.**

The total of the points of all employees will be divided into the total profit to be shared and a point value established. Each employee may then readily determine the exact amount of his profit share.

There follows an illustration of the operation of the point system for a particular employee:

OPERATION OF POINT SYSTEM

| Year of Service | History | Basic Remuneration | Basis of Points | Calculation of points | Total Points |
|---|---|---|---|---|---|
| First | Commencement | $2,400. p.a. | $10.00 = 1 pt. | 240. | |
| | Length of service | | 2% of 240 | 4.8 | 244.8 |
| Second | Given raise same position | $3,000. p.a. | $10.00 = 1 pt. | 300. | |
| | Length of service | | 4% of 300 | 12. | 312. |
| Third | Promoted with higher salary | $4,000. p.a. | $10.00 = 1 pt. | 400. | |
| | Length of service | | 6% of 400 | 24. | |
| | Special award | | 5% of 400 | 20. | 444. |
| Fourth | No change | $4,000. p.a. | $10.00 = 1 pt. | 400. | |
| | Length of service | | 8% of 400 | 32. | 432. |

Let us assume that the 78 non-executive employees in our illustration achieve a total of 36,000 points at the end of the first year and that there is $36,000 in the profit pool. Since each point has a value of $1.00, the employee in this illustration, therefore, will receive $244.80 at the end of his first year of employment.

## Administration of Employees' Profit Pool

### *A. Period of Declaration of Profits*

Profit shares may be determined monthly, quarterly, or yearly without disturbing the point system. For ease of administration, however, I suggest that the points for the ensuing year be those established at the end of the previous year after the special awards of the previous year have been deducted. Adjustment for length of service should only be recognized at the end of each year of service.

### *B. Allocation of Profit Shares*

While the profit shares might be declared monthly or quarterly actual allocation or payment should not be made in full on a monthly or quarterly basis. Payment might be deferred entirely until the end of the profit year or limited to an interim monthly or quarterly payment not to exceed, say, 50% of the amount declared. These limitations will permit adjustments for possible losses in off-months, changes in the number and remuneration of employees, and special awards. The partial deferment would also discourage employees from leaving service at least until after a year-end.

### *C. Appointment of Trustees*

A committee of trustees might be established consisting of an equal number of representatives from the employees and from the company with a third party selected as chairman by agreement between the other representatives. The principles of the plan should be incorporated in a trust deed which appoints the trustees to receive the employees' share of the profits and to implement distribution.

It might be desirable to provide that an auditor's certificate be delivered to the trustees stating that the profit-share payable in a specified amount has been determined in accordance with the terms of the plan. The company will pay the amount specified in each year to the trustees who will allocate the individual shares, make the necessary payments, and administer the investment of any funds left on hand.

## Taxation

Section 79 of the Income Tax Act relates to profit-sharing plans and provides in essence as follows:

1. The employees' share of profits must be pre-determined and based upon business profits.
2. Payments under a plan must be paid over to a trustee created by a trust deed.
3. The trustee must allocate the amounts received to all beneficiaries under the plan in the year of receipt by the trustee.
4. The amount paid to the trustee is deductible by the company as an expense in the year of deduction, so long as the trust is in effect.
5. The trust as such is not taxed.
6. Amounts allocated by the trustee become taxable income in the hands of the beneficiaries in the year of allocation whether actually paid or not. The net amount of interest earned or paid, dividends received, gains or losses on investments and ordinary expenses of the trustee become a part of the total amount which must be allocated to the beneficiaries.

If sums allocated are not paid in full in a year and subsequently there arises a redistribution which reduces the original allocation, the beneficiary will have been subjected to a tax on an amount greater than the eventual receipt. There is no provision for adjustment of this overtaxation other than that the taxpayer might presumably declare the reduction, apply for a re-assessment of income, and cause the excess tax paid to be credited to any other income tax liability.

If the sums eventually received exceed amounts previously allocated, the excess becomes taxable in the year of receipt.

The trustee would be required to withhold from the sums allocated the appropriate deduction for personal income tax, although the company would probably assume responsibility to ensure that deductions were made.

### Actual Cost of Plan

The actual cost to the employer of installing our illustrated profit-sharing plan would be as follows:

| | Operating Profit | Profit-sharing distribution | Profit subject to income taxes | Federal income taxes | Net profit after income taxes |
|---|---|---|---|---|---|
| Before installing plan ............ | $400,000 | Nil | $400,000 | $190,200 | $209,800.00 |
| After installing plan ............ | $400,000 | $72,715 | $327,284 | $154,569 | 172,715.23 |
| | | | | Actual effective cost = | $ 37,084.77 |

The foregoing represents only one possible outline of a profit-sharing plan but illustrates the essential principles common to all successful plans. Various combinations of the factors involved may be tried in order to find that arrangement which will be best suited for any particular organization or purpose.

## A HAIR OF THE DOG

S. B. Brown, Australian chartered accountant, reports that in Australia some persons, not members of the recognized Institutes of accountants and therefore not bound by codes of ethics, "advertise fairly extensively for professional work", particularly in the country areas.

To overcome this, one of the Institutes authorized a form of advertisement to be inserted from time to time in the press "in any country area selected by the relevant State Council". The advertisement carries the full name of the Institute and reports that the announcement is made "for the information of the public". Then it sets forth the "sort of person a chartered accountant (Aust.) is professionally" and notes that he is forbidden to advertise or canvass for business.

—From *The Accountant*, March 1953

# After Three Score Years and Ten

By H. Percy Edwards, F.C.A.

**Highlights in the history of the Institute of Chartered Accountants of Ontario culminating in the opening of its new building on May 27, 1954**

TWO methods are used by writers to present historical happenings. The one builds a story of individual heroism around certain facts which are purely incidental, producing in the reader an immediate interest without lingering impressions. The other deals with facts and enlists the cooperation of the reader in the building up of scenic effects. In this recital of incidents I have chosen to follow the latter method. There are dates and figures to satisfy the statistical-minded and heroes aplenty for those who care to enter into the spirit of the Institute's early days.

While the Ontario Institute did not receive its charter until 1883, the work of organizing it dates back to a meeting held on November 11, 1879 at the office of Robins, Myles & Co. in response to invitations sent to all the "public accountants, accountants in banks, monetary institutions, and insurance companies, representative bookkeepers and others in Toronto". Eighteen persons attended this meeting and passed a resolution "that it is desirable to form an Association of Accountants for the Dominion of Canada". William Robins, William Fahey, M. Robins, H. W. Eddis, and William Anderson were elected the original members of the Institute to ballot for applicants and to prepare a constitution and by-laws. These men were instructed to "frame the rules, as far as possible, on the model of the Institute of Accountants of Great Britain".

Nearly a month later, on December 10, 1879, the first general meeting of the Institute was held with an attendance of 24 original and elected members. The original members retired and submitted their applications for membership. Upon a ballot being taken they were elected to membership. The constitution and by-laws of the "Institute of Accountants and Adjusters of Canada" were adopted.

The first president of the Institute was Charles Robertson and the first vice-president William Anderson. They were supported by a Council consisting of Hugh Scott, William Badenach, E. R. C. Clarkson, James E. Day, William Robins, James Watson, D. O'Reilly, F. J. Minet, and H. W. Eddis. Council later appointed William Robins as

A condensation of an article by H. Percy Edwards, F.C.A., entitled "Three Score Years", published in *The Canadian Chartered Accountant*, February 1940 and of an additional article by Mr Edwards on the history of the Institute from the end of that period to the present time.

secretary-treasurer and instructed him to procure the necessary stationery and books.

That the accountants of those times experienced a pressure of work during the early months of the year seems to be borne out by the fact that three meetings called in January, February, and March of 1880 failed for lack of a quorum! However, Council did make arrangements with the Board of Trade for the use of a room at $80 per annum, without taxes, and the secretary bought a table for $20 which was moved into the room ready for the next general meeting on April 15.

Meanwhile accountants in other Ontario centres began to show an interest in the new Institute. By the end of the year 1880, the Institute had a total membership of 59, of whom 43 were resident in Toronto, eight in Hamilton, six in London, and one each in Brantford and Belleville.

Under the second president, William Anderson, the Institute extended its activities. Several members gave a series of talks upon subjects of interest to accountants and to the business public. Typical of these was an address by H. W. Eddis on "Balance Sheets" in May 1881.

### Application for Incorporation

It remained for the next president, S. B. Harman (one time Chief Magistrate of Toronto), to secure incorporation of the Institute although an unsuccessful attempt had been made earlier. A man of tremendous vision and understanding, he saw to it that every member of the Legislature was well acquainted with all phases of the Institute's objects and activities. When presented, the petition for incorporation was accompanied by a list of 211 names of accountants from 22 cities and towns in Ontario and elsewhere. On March 9, 1883 Mr. Harman addressed the Institute concerning the charter "which", he said, "it was a matter of satisfaction had been successfully carried in the Legislature and was now the law of the land as 46 Victoria (1882-3) chapter 62".

And so, cradled in a voluntary association, was born "The Institute of Chartered Accountants of Ontario".

No time was lost in amending the bylaws to conform with the Act of Incorporation, and those members not specifically named in the petition were asked to renew their application for membership. As a result 116 immediately responded and were duly elected members.

### Qualifying Examinations

In the period which followed Council framed the rules for the examination of candidates for the "Diploma of Fellowship" and the "Certificate of Competency". The requirements of examination for the diploma called for "such high qualifications and recognized efficiency as shall warrant the Council in endorsing the candidate for the practice of a public accountant". On the other hand the certificate required of the candidate a familiarity with the principles which govern all accounts and the exhibition of good methods in his own department. He was not expected to exhibit a knowledge of "modes of recording and distributing which prevail in lines of business foreign to his own experience".

In his report to the annual meeting of 1885, the president referred to the rules regarding examinations and the granting of diplomas and certificates to its members. He earnestly hoped "that the members generally during the coming year will avail themselves of the opportunity of obtaining diplomas and

certificates as authorized by the Act of Incorporation".

This quotation deserves more than passing mention. There is, in the minds of many, an impression that the early members secured the privilege of calling themselves chartered accountants without passing any examinations. I have always understood that examination has been the only gateway to admission in the Institute. This appears to be borne out by the records, for we find the name of E. R. C. Clarkson among the petitioners for the Charter of Incorporation and later as having presented himself for examination for the diploma entitling him to use the designation "Chartered Accountant". In November 1887 Council published a declaration that the designation "Chartered Accountant" shall belong exclusively to members of the Institute practising as public accountants while continuing in membership.

The first recorded granting of a diploma to a member of another accounting society was upon the application of Michael Crawley who, upon producing his certificate of fellowship in the Society of Accountants and Auditors of London, England, was made a member of the Ontario Institute.

### Admission of Women

In 1894 Council met to consider the case of a lady who was an unsuccessful candidate for the diploma at the recent examinations. They decided that if an offer of an associate certificate would be acceptable to her it would be issued as provided by the by-laws. The lady in question did accept, and so for a short time the problem of admitting women to the profession was postponed.

However, the next year Council received three more applications of like nature and a general discussion ensued. Many and varied were the reasons given by individual members for admitting or barring women. Some expressed the opinion that the nature of the accountant's duties in factory and arbitration work was unsuitable for ladies; some considered that "the employment of women clerks was detrimental to the value of male labour"; one feared that women would have a preference because they would ask a lower fee. Others thought that proficiency shown in passing the examinations should be the sole test of their admissibility. When a vote was taken it was unanimously decided not to admit women to membership, and in reaching this decision Council was mainly guided by the precedent of other professional societies. Upon this decision the Council of 1912 refused to allow two women to sit for the examination of that year.

While upon this subject we may bridge the gap of years and deal finally with this question. The women persisted in submitting their applications, and succeeding Councils were forced to re-open their discussions and eventually permit women to qualify and sit for examination. The changed attitude of other professions and the general entry of women into business life were the determining factors. In February, 1930 among those admitted to membership was Helen Sutcliffe Burpee, the first woman to qualify and become a chartered accountant in Ontario.

### Early Educational Efforts

From time to time leading members gave papers on subjects of particular interest to students, and the examination questions of former years were published and sold to candidates. When Upper Canada College established a department devoted to the study of accounts, it became affiliated to the Institute, as did the Northern Business College in Owen

Sound and the Ontario Business College in Belleville. Because the masters of these affiliated schools were members of the Institute, they were permitted to conduct the primary examinations under rules prepared by the Examination Committee in 1893. On occasion other business colleges were granted the same privilege.

The Examination Committee drew up five forms for the use of applicants. One of these, called "Student-Associate", was an early indication of the Students' Association which was to become an important factor in the education and preparation of students for membership in the Institute.

### Recession in Membership

In the ten-year period from 1884 to 1894 the numerical strength of the Institute fell by more than one half. Many of the earlier members did not put forth the effort to qualify for the designation of chartered accountant, mainly because they were not engaged in public practice. Another group were struck from the roll for non-payment of dues. By 1894 the Institute showed a total membership of only 78. However, those who stayed with the Institute were men who took the affairs of their profession very seriously and who determined to maintain the high standards on which it was founded. Even at this early stage there is record of three complaints lodged with Council concerning the conduct of members in their professional practice.

### Dominion-Wide Organization

As early as 1882 Mr S. B. Harman had declared in his inaugural address that "the day may not be far distant, when, by a happy union, Canada at large may become the field of labour and usefulness of a Dominion Institute". But I suspect that the turn of events some 20 years later could not be said to correspond with what Mr Harman had in mind. It was in February 1902 that the members of the Ontario Institute first learned that an application was to be made to the Dominion Parliament to incorporate an Institute of Accountancy whose members would be styled "Chartered Accountants". Of course this application constituted a grave menace to the Ontario Institute and at a special general meeting on February 15, 1902 the members decided to cooperate with the societies in Montreal and Winnipeg in opposing the Bill. The procedure they followed was to ask the promoters of the Bill to remove objectionable clauses granting educational powers and to change the corporate names and titles so as not to conflict with those adopted by the Ontario Institute. As a result the Bill was amended, and the Act to Incorporate the Dominion Association of Chartered Accountants received assent on May 15, 1902. The Ontario men were under the impression that they were to be charter members of the Association and probably would be invited to attend its first meeting.

Nothing more was heard of the matter until about November when the Ontario Institute began taking steps to qualify its members to become members of the Dominion Association. It was then learned that under the plan of organization of the Dominion Association the majority of the Ontario Institute would be admitted to membership on terms less favourable than had been expected. So for six years the Dominion Association carried on as an independent organization of professional accountants while the Ontario Institute continued to function as before.

Needless to say, with two bodies qualifying chartered accountants, each according to its own standards, the public mind was becoming highly confused as to just what a "chartered accountant" was supposed to be. In 1908 the Insti-

tute persuaded the Ontario Legislature to pass an Act by which the right to use the term "chartered accountant" was reserved for members of the Ontario Institute. At the instance of the Dominion Association, however, the Ontario statute was disallowed by the Governor-General-in-Council. Then followed an extensive campaign of newspaper articles designed to inform the business public concerning the facts of the case from both points of view. The effect of this campaign was at last to bring the Dominion Association and the various Provincial Societies together, and a settlement of all problems was reached when the Dominion Association passed under the control of all the Provincial Societies of whose members it was henceforth to be composed. Re-enactment of the disallowed legislation was asked and obtained. Matters of organization were speedily completed which established the profession in Canada on a basis as sound as that of any other country.

Despite the era of difficulties through which it had just passed, the Ontario Institute continued to grow in numbers. In 1908 the president, J. W. Johnston, reported that the membership consisted of 105 associates and 22 fellows. In that year 87 candidates applied to write the primary examination, 111 the intermediate, and 33 the final.

Financial conditions had also improved, the accumulated surplus amounting to $1,715.36 in 1908. The library had grown to a total of 117 items including text books, journal, and financial reports, although with characteristic conservatism our professional forefathers valued it at $9.43 for balance sheet purposes!

By 1913 the affairs of the Institute had grown to such proportions that it became necessary to appoint a full-time registrar. To that position came W. J. Valleau who rendered faithful and valuable service for many years. Upon his retirement in 1935 he was unanimously elected an honorary life member of the Institute.

In 1911 the first issue of *The Canadian Chartered Accountant* was published by the Dominion Association of Chartered Accountants. Shortly after his appointment as registrar of the Ontario Institute, Mr Valleau also assumed the duties of editor of the magazine until succeeded by Austin H. Carr in 1930. The development of the magazine under Mr Carr belongs to Canadian Institute history and has no place in this narrative. It is a matter of satisfaction to the Ontario Institute that through the temporary use of its facilities it was able to foster the more recent developments of Dominion Association affairs.

### The Profession and World War I

The profession in Ontario, as elsewhere, looks back upon the years 1914-1918 with a sense of pride that the Institute's members played their part with distinction. The annual report for the year ending June 30, 1918 showed that the Institute had donated $1,000 for the purchase of a Lewis machine gun and contributed $700 to the Red Cross Society. This contribution amounted to 37% of the Institute's surplus accumulated over a period of 38 years.

Out of a total enrolment of 252 members and students, 60 enlisted for overseas service before the introduction of compulsory service. In addition there were many others who served their country in other capacities for which their training and skill had fitted them.

### Courses of Instruction

The financial burdens imposed by the war caused Parliament to introduce a system of taxation on income which immediately broadened the scope of the accountants' work and at the same time

demanded a higher standard of professional knowledge and competency. Accordingly, examination standards were stepped up, library facilities were improved, and the Institute embarked on a plan to provide a study program for the student body. A board of instruction, consisting of George Edwards, chairman, T. Watson Sime, Rutherford Williamson, and R. Easton Burns, was appointed in January 1921 to negotiate with existing schools for such a course of instruction. Arrangements were completed with Queen's University to conduct the courses on behalf of the Institute. Then a select committee of the Institute collaborated with the faculty of the University to produce a course of lessons which were put into operation in January 1922. These courses, called first, second, and third year, were designed for the primary, intermediate, and final examinations, respectively. Students were now obliged to complete the respective courses before sitting for examination.

The Institute might have capitalized upon these courses by making them available to any who wished to subscribe, but decided to restrict their use to registered students and to those students who were enrolled with other Provincial Institutes of Chartered Accountants. The study course, later expanded into a five-year program, has become "standard equipment" for students in nine out of ten Provinces, with even the tenth making partial use of it. Its widespread use has done much to bring about a uniformity of standards among the various Institutes. Since 1939 there has been a standardized examination for all candidates seeking admission to any of the Institutes.

Again keeping abreast of the times, the Institute embarked in 1951 on a five-year plan to revise its study course from stem to gudgeon. At the moment of writing this project might be termed work in process!

### Jubilee Celebrations

In 1933 when the Institute celebrated its Golden Anniversary it was able to boast of a membership of 591 persons. The celebration took the form of a dinner which was attended by many dignitaries. By contrast the Diamond Anniversary, attained on November 11, 1939, passed without notice because of the declaration of war in September of that year.

### The Second World War

In World War II as before, members and students flocked to their country's colours, with over 35% of the total enrolment enlisted in the armed forces. Of these, nine members and 23 students made the supreme sacrifice. Again, too, an unrecorded number of members rendered service in civilian capacities directly associated with the war effort.

The Institute actually operated at a small financial loss during the years of this second war. It remitted annual dues to members on active service, made substantial cash donations to the Canadian Red Cross and other national war charities, and extended facilities to enlisted students to help them complete their studies and examinations during their period of military training.

### Post-War Expansion of the Profession

Immediate post-war activities were directed toward preparing refresher study courses for members and students and to assisting other war veterans who were attracted to chartered accountancy as a profession. Modern business, beset on every side by new complexities, was urging the profession to pay attention to its needs and supply men to its ranks. However, the temptation to gain numerical strength at the expense of reduced standards was successfully resisted. Instead, the Institute has raised its minimum educational requirement of students

entering the profession from Junior Matriculation to Senior Matriculation standing. It has also geared up its study courses to keep pace with the business tempo.

Another problem faced the profession. Many individuals and groups with inadequate accounting qualifications were offering themselves to their community as public accountants, and the public mind was becoming confused. The Institute, working with other bodies of accountants, presented the matter to the Ontario Government. As a result the Public Accountants Act 1950 was passed to regulate the practice of public accountancy in Ontario and to provide a minimum standard (about the level of the Institute's intermediate examination) for all persons designating themselves as public accountants.

Perhaps the most graphic way to tell the story of the Institute's post-war expansion is by means of figures. At the cessation of hostilities in 1945 there were 1,053 members and 324 registered students. Today the record shows 2,260 members and 1,265 students, so that the former is more than doubled and the latter almost quadrupled in less than ten years' time. It is interesting to note that the 209 members admitted in February 1954 exceed the total membership of 202 in 1916.

### The Latest Step in Progress

By 1953 the Institute had accumulated a surplus of $97,193.15, a happy position which it had attained only since 1924, for it was in that year that the then surplus of $8,553.01 was almost wiped out by the failure of the Home Bank. (It was the irony of fate that the Home Bank was the only one which did not engage a chartered accountant to audit its accounts!) However, now that they had a solid surplus of nearly $100,000, the members felt justified in giving attention to the perennial problem of housing their Institute and decided at a special general meeting to build their own Chartered Accountants Building at 69 Bloor Street East, Toronto. Contracts were awarded and construction commenced in the fall of 1953. Progress reports of its construction, appearance, and accommodation have appeared in *The Canadian Chartered Accountant* and need not be repeated here. In appearance and furnishings it reflects with dignity the best traditions of the profession and is an outstanding event marking the development of the Institute over three-quarters of a century. As one gazes at the imposing crest over the door it is perhaps not unfitting to recall the words from the inaugural address of the first president, Mr S. B. Harman, that "the arduous profession of an accountant is one which, rightly undertaken, elevates the labour employed and raises the treatment of figures to the nature of a science, thus justifying the motto adopted for the seal of the Institute of Accountants of Ontario, *Scientia et Labore*.

## CORRIGENDUM

We regret that in the March 1954 issue we referred to Professor F. Sewell Bray as Stamp-Martin Professor of Accounting at Cambridge University. Actually he is Stamp-Martin Professor of Accounting at Incorporated Accountants' Hall, London. The Stamp-Martin Chair was created in 1953 by the Society of Incorporated Accountants and Auditors, which appoints the holder of the Chair and is financially responsible for it. Professor Bray also holds a Senior Nuffield Research Fellowship in the Department of Applied Economics at Cambridge University.

LIBRARY OF THE INSTITUTE OF CHARTERED ACCOUNTANTS OF ONTARIO

CORNER OF THE GENERAL OFFICE OF THE CANADIAN INSTITUTE OF CHARTERED ACCOUNTANTS

Committee Room of The Canadian Institute of Chartered Accountants

The Chartered Accountants Building, 69 Bloor Street East, Toronto

# Time, Costing, and Billing Procedure for a Firm of Accountants

By C. K. MacGillivray, F.C.A.

**An outline of a system of time records, staff expense accounts and procedure which is adaptable to the requirements of any accounting practice**

THE two principal factors which almost all public accountants take into consideration today in setting their fees are the amount of time spent and the degree of professional competence supplied. Since the degree of competence of the various members of the staff usually bears a close relation to the amounts of salaries paid to them, the actual cost of direct time used on a client's job is the soundest basis on which to start in determining a reasonable fee. Some firms merely divide their audit and accountings clerks into different categories depending upon their individual skill and knowledge or salary scale and use standard selling rates per hour for each category as a general guide when setting the fee. Although simple, this standard rate plan might make a cost accountant flinch at the thought that a fellow accountant might be using it without a definite knowledge of the related cost figures. To permit a close and realistic approach to the management of its own affairs any firm of accountants will find it advantageous to use a proper system of recording and calculating job costs for the following purposes:

(a) As a guide to fee-setting on a consistent and reasonable basis;

(b) To account satisfactorily for all the time of the staff and partners;

(c) To ensure that all direct disbursements for a client's account, other than salaries, are included in the bill;

(d) To enable the partners to evaluate the work as it progresses, so that excessive costs will not be built up and clients may be given indicative interim bills or fairly accurate fee estimates during the conduct of unusual or lengthy undertakings;

(e) To provide comparative costs on each job each year which may be used for developing top efficiency, indicating an objective to the man in charge at the commencement of an assignment, serving as a guide to incentive or other employee bonuses, and similar objects;

(f) To determine the cost of various types of unproductive effort, lost time, the time spent on the firm's own administration, charity work and other such matters; and

(g) To assist in preparation of the firm's own interim and annual financial statements on a better basis than that calculated on a cash received or bills rendered plan.

The system of records installed should be adequate to provide information for the foregoing purposes, but planning will be necessary to ensure that the clerical work involved is kept to an economical level. Each firm has its own unusual conditions and individual ideas on the amount of record-keeping which it needs and the nature of the information which it wishes to use for its own management. In this article a particular system of time records, staff expense accounts, and procedure which would be suitable for small, medium, or large practices is described briefly. Only minor adaptations will be required to meet individual circumstances. Some possible variations are indicated by a numbered "V" sign in the text, and these variations will be described briefly at the conclusion of the article. Thus the reader will be able to expand his thinking beyond the brief descriptions given here and to modify the plan to suit his own needs.

The particular records used in the plan described are set out below:

1. Daily time sheets
2. Weekly time summary sheets
3. Semi-monthly expense reports composed of:
   (a) Direct expense slips
   (b) Semi-monthly expense summaries
4. Job cost files:
   (a) current
   (b) billed
5. Costing summary sheet
6. Billing instruction sheet
7. The bill

### Daily Time Sheets

A daily time sheet (see p. 369) may be about 5″ x 8″ in size, printed and gummed on one edge, and made up in pads of 50 or 75. It should be designed with a line at the top to show the name of the client, and below should appear a second line to permit the recording of of a standard classification of the work done for him if a division of costs is being kept under separate categories for the same client. A ruled box in one corner of the sheet is reserved for the employee's initials or name. In the main body of the form the ruling will provide places for the date, a description of the work done by the employee for the client that day, and on the right hand side, two columns for the number of hours spent, the first being for normal hours and the second for overtime. Each employee may keep one or two pads of these forms in his briefcase or in his desk and should fill out one sheet or more as required at the conclusion of every working day. The same time sheet may be used for two, three, or more days' work in the same week if it is performed for the same client, providing each day's work and hours are set out separately. Daily time sheets also are made out for unproductive classifications such as lost time, vacations, illness, etc. The minimum time to be recorded for any one entry may be set at half an hour, but often time sheets may record telephone calls, short conferences, or the like with no time charge made on them. Several of these "no charge" sheets may be treated as the equivalent of one half hour in costing.

Each partner, staff supervisor, specialist, or other member of the organization who works directly for clients even though not in their offices must also make out the daily time sheets. Partners or others who frequently spend time on a number of jobs each day probably will find the use of the dictating equipment near the end of the day's work or the first thing in the morning the most practical method of meeting their daily time sheet requirements.

All unusual or important matters which occur when a primary record of date and facts may be needed later, such as policy or fee discussions with clients or the discovery of a defalcation, should

be set down on the time sheets and underlined. The staff should be coached to mark any special service performed beyond the limits of the regular engagement so that its time may be segregated and billed if of sufficient consequence. (See (V-1) on p. 368).

### Weekly Time Summary Sheets

The weekly time summary sheet is a somewhat larger form on which is recapitulated in chronological order the time of an employee or partner at the end of the week as shown by his daily time sheets. Each employee should make out his own, but those of partners may be prepared by an office clerk or secretary. The name of the person reporting is shown at the top of the sheet as well as the opening and closing dates of the week being reported. Below, opposite the date of each day of the week are shown merely the name of the client or clients for whom he worked that day and the number of regular business hours and the overtime hours spent on the work.

By regulation, each employee's weekly time summary sheet with attached daily time sheets must reach the accountants' office not later than the following Tuesday morning. One of the regular office clerks must then check them over to make sure they are in order and that all normal working hours are accounted for satisfactorily. Any irregularities should be reported to the management as prescribed. The clerk should stamp or mark in coloured ink each daily time sheet with a large letter such as A, B, C, D, etc. in a designated corner of the form, these letter classifications representing salary groups for which she has a confidential key schedule. For instance, all employees receiving from $1.21 to $1.40 per hour for normal time might be classed as "E" and brought into the costs at their average of $1.30, those being paid from $1.41 to $1.60 per hour might be

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classed "F" and brought into the costs at $1.50 and so on. (See (V-2) and (V-3) on p. 368-9). Partners' time will be costed at fair fixed salary rates. The daily time sheets and weekly time summary sheets are then ready for filing.

### Expense Reports

Each member of the staff who incurs an out-of-pocket expense for which he should be re-imbursed is expected to record it on a pink direct expense slip bearing the client's name if it is a direct cost chargeable to the client's job, or on a semi-monthly expense summary if it is an administrative or overhead item. When preparing to turn in his expense report, the employee summarizes the pink direct expense slips on the semi-monthly expense summary so that the latter shows sub-totals both for direct expenses and for overhead expenses as well as his total expenses for the period. The pink direct expense slips and the semi-monthly expense summary, bearing the signature of the employee, are both sent in to the office twice monthly, and any supporting bills for hotel costs, account books purchased, etc. are attached to it. The periods covered by these twice-monthly reports are from the 11th to the 25th, and from the 26th to the 10th inclusive of the following month. The staggered periods permit the reports to be prepared, delivered to the office, and processed for payment in time to include the approved expenses in the employees'

twice-monthly salary cheques. After approval, the pink slips are filed as described later and the summary becomes an accounting voucher for the re-imbursement issued to the employee. If any large item of cost is incurred by the administrative office for a client, a pink slip should be made out for it also and filed in the cost files. (See (V-4) on p. 369)

### Job Cost Files

Filing drawers, known as current job cost files, should contain separate folders with visible tabs for each client and also for each category of work for which individual costs may be required on any particular client's work. A very suitable type is the drawer fitted with bars on each side along which the files or folders slide on metal guides, permitting the filing or extraction to be done with ease. In one of the drawers will be files for unproductive time classified into various divisions required by the partners, such as lost time, vacations, illness, administration, staff meetings and training, Institute activities, business promotion, examination time off, and other authorized absence. The clerk responsible for checking in the daily time sheets will file them in the corresponding individual files for each client or unproductive time classification. The pink direct expense slips should be placed in the same folders as the daily time sheets. The daily time sheets and direct expense slips to be found in a client's current job cost file at any time represent the time spent and direct expenses for which a complete billing has not yet been made.

Later when the bill has been prepared, the daily time sheets which are represented by that bill are fastened together with a top sheet or light folder giving the client's name and the consecutive number of the costing summary sheet on which they were recapitulated. They are kept thereafter in alphabetical order for further reference in a separate cabinet called the billed job cost file which will be considerably larger than the similar current file.

### Costing Summary Sheet

When the time comes to bill a client, the daily time sheets should be taken from the client's current job cost file, sorted, and totalled on an adding machine to show the hours spent for each staff letter classification indicated on the time sheets. A costing summary sheet (see p. 370) should be headed up and the total hours for each classification then extended at the average salary cost of that range. The costing summary sheet form should be laid out to provide a heading for the name of the client and lines for the first and last dates of the time sheets represented both for each lettered salary range and the average applicable cost rate and also for the total cost of direct time so calculated. Provision should be made also for entering the cost of overtime hours on whatever basis the firm has adopted. The elements of cost would be summarized by a clerk on the bottom of the form somewhat according to the example given herewith:

| | |
|---|---|
| Cost of direct time | $210.00 |
| Add — allowance for unproductive time — 15% | 31.50 |
| Total time cost | 241.50 |
| Overhead — 40% of total time cost | 96.60 |
| Total time and overhead cost | 338.10 |
| Profit — xx% | xxx.xx |
| | xxx.xx |
| Direct expenses | 15.00 |
| Total for billing | $xxx.xx |

The figures represented by x's will be inserted by the partner responsible for

setting the fee. The profit percentage used will be a standard figure in the majority of cases but will be adjusted upwards or downwards for certain bills as circumstances indicate. Of course, where a fixed fee has been quoted in advance or there is some other restricted limit, the above summary will be worked out in part backwards to determine the amount and rate of profit last. The figure decided upon for the fee will be usually a round amount, omitting cents and approximating the total for billing on the lines above. Salary rates and profits vary greatly in various cities and areas throughout the country, as well as depending on the nature of the work, the reputation of the firm, and many other factors, so that no very definite rule of thumb may be given. Each firm must work out its own regular formula and policies for itself.

To arrive at the cost per hour for each employee's direct normal time, the total number of regular working hours in a year should be divided into the annual normal rate of pay. Let us assume, for instance, that a firm's normal working hours total 1,881 in a year after deducting statutory holidays. Then an employee who was paid $225.00 per month would be on a $1.44 per hour basis and classified as in "F" category, so that his direct time would be costed at $1.50 per hour, which is the average rate for that class.

The percentage to be used as the allowance for unproductive time would be estimated at the commencement of each financial year for employees engaged in productive work but not for those engaged in typing, secretarial, or such administrative jobs. (See (V-5) p. 369) For example, of the assumed 1,881 usable normal hours in a year it might be estimated readily from previous records and current forecasts that every direct worker would have an average of about 245 unproductive hours, so that indirect effort and lost time could be calculated for this purpose at about 15% of the 1,636 productive hours in the year.

Overhead expenses would include the salaries of stenographers and secretaries and all expenses of operating the practice except the salaries of employees and partners engaged directly on clients' work. The rate of overhead to be used on the costing summary sheet would be determined from the current year's forecast or a budget which might be based in part on the income and expenditure statement of the previous year.

If a further check is required on the full charging of direct expenses reported on the semi-monthly expense reports, an account may be opened in the general ledger called "Disbursements Chargeable to Clients" to which the outlays would be charged from the cash book and the direct expense items would be credited from the monthly billing summary prepared from the bills rendered. When account books and other such items are bought and paid for directly by the firm as a convenience to clients, it might be made a policy to bill the client immediately for those disbursements rather than to wait perhaps for months until a bill for services is to be rendered.

The costing summary sheets are given numbers in sequence and filed on a ring-type binder so that any one may be removed temporarily to show to a partner when he is finalizing a later bill.

There are numerous plans which are used by public accountants to remunerate their staff for the overtime work which is so necessary in the profession. Some may consider a reasonable amount of overtime as normal. Others may bring the overtime into the calculations for periodic bonus or incentive plan distributions. In many cases, a slight change in the overtime arrangement will permit an

accurate costing. Wherever overtime allowances are paid to the staff, however, it should be possible for each firm to work out a satisfactory costing procedure for them within the framework of the system here described.

### Billing Instruction Sheet

The partner who determines the particulars of the bill would use a billing instruction sheet to save time, to adhere to standardized wording, and to simplify typing instructions. This form would have numerous descriptions of the more usual types of work done, the wording being carefully planned and in accordance with the firm's established policies. The partner should indicate by a tick the particular items which applied to the bill being rendered, merely inserting dates or supplementary particulars where necessary. Blank lines at the bottom permit him to write in any further or special wording desired. (See (V-6) on p. 369)

### The Bill

The form of the bill calls for little comment except that it should be set out in a neat and professional manner, which will create a favourable impression and give an indication of the high standard of work done. The sequence number of the related costing summary sheet may appear inconspicuously. As accountants' bills are usually paid in full with one remittance, a system involving the preparation of about four copies of each bill and the elimination of an accounts receivable ledger is readily adaptable to all the needs of bookkeeping and management. When a new bill is to be rendered, a perusal of previous bills to that client is more useful than a scrutiny of the orthodox ledger sheet. The original bill goes to the client, the second is placed in the accounts receivable file, the third is maintained in numerical order in a binder for monthly summarizing and general ledger entries, and a fourth if desired may be used for the first statement of account or overdue reminder. When a bill is paid, the second copy is so stamped and dated in the usual way and transferred to a paid bills file, each client's bills being kept separate. (See (V-7) on p. 369)

### General Comments

The system described saves a clerk spending numerous hours of posting and maintaining cost and accounts receivable ledgers. It also reduces the office work to a reasonable minimum consistent with the results obtained. It will permit a firm to account for its revenue on a cash or bills rendered basis, on a basis of the profit being taken only on complete jobs with incomplete jobs being brought in at nil or at cost, on a basis of the income estimated to be realizable on all work performed, or on several other variations to suit the policy of the firm. Partners' time charged may be accumulated on the monthly billing summary, if it is desired to use the information for any purpose.

### Some Variations

(V-1) Instead of sheets, some firms may find that an efficient system can be built around the use of cards on which each employee records his time, the cards permitting side-punching and needle-sorting for all the analyses and summaries that are required. The method of filing would differ from that described in the main outline.

(V-2) The daily time sheets may be pre-printed with the various salary classifications and even ordered in a variety of colours. In that event it will not be necessary for the office clerk to classify and mark the time sheets before filing as each man will be given daily time sheets of a letter and colour which indicates the salary range in which his salary is located. This will simplify the work at time of costing because colours may be sorted together more readily. Where

the salary scales are confidential, this plan would not be suitable.

(V-3) To obtain very close to accurate costs, it is feasible to find the exact cost per hour of each employee after allowing for non-chargeable time, so that the clerk who is classifying the daily time sheets may write on them the exact cost rate rather than the average rate.

(V-4) It is possible to provide on the weekly time summary sheet a space for each employee to list his expenses for the week and to sign opposite the total. Direct expense disbursements would then be treated in a manner somewhat different from that described in the main outline.

(V-5) If desired, the costing of time may be extended to certain office employees who customarily spend many hours which can be allocated directly to clients. In that case they would be expected also to make out daily time sheets, and their salaries would not be considered entirely as overhead.

(V-6) Many accountants prefer not to go into very specific explanations on their bill, but merely to give some such general description as "To fee for accounting services rendered".

(V-7) As an alternative to the multiple bill system, a ledger with visible names and extractable card ledger sheets could be used with markers to indicate future billing dates when monthly, quarterly, or semi-annual bills are to be sent out. This card ledger system with markers might also serve in small firms as an up-to-date clients' mailing list or reference and as a reminder of various deadline dates such as for filing tax returns.

| Employee's initials | | **DAILY TIME SHEET**<br>Client ..........<br>Work classification .......... | For office use | |
|---|---|---|---|---|
| *Date* 195 | | *Particulars* | *Normal hours* | *Overtime hours* |
| | | | | |
| | | | | |
| | | | | |
| | | | | |
| | | | | |
| | | | | |
| | | | | |
| | | | | |
| | | | | |
| | | *Total Hours* | | |

COSTING SUMMARY SHEET

Sequence no.
Client ........................................ File no.

Work classification ........................................

Period covered by time sheets — From ..................195 To..................195

Date of last bill ..................195 Amount of last bill $

| Time Class | | | *Normal Time* Hours | Rate | Amount | *Overtime* Hours | Rate | Amount | *Total Amount* |
|---|---|---|---|---|---|---|---|---|---|
| A | 0-60 | A | | 55 | | | | | |
| B | 61-80 | B | | 70 | | | | | |
| C | 81-100 | C | | 90 | | | | | |
| D | 101-120 | D | | 1 10 | | | | | |
| E | 121-140 | E | | 1 30 | | | | | |
| F | 141-160 | F | | 1 50 | | | | | |
| G | 161-180 | G | | 1 70 | | | | | |
| H | 181-200 | H | | 1 90 | | | | | |
| I | 201-220 | I | | 2 10 | | | | | |
| J | 221-240 | J | | 2 30 | | | | | |
| K | 241-260 | K | | 2 50 | | | | | |
| L | 261-280 | L | | 2 70 | | | | | |
| M | 281-300 | M | | 2 90 | | | | | |
| N | 301-340 | N | | 3 20 | | | | | |
| O | 341-380 | O | | 3 60 | | | | | |
| P | 381-420 | P | | 4 00 | | | | | |
| Q | 421-460 | Q | | 4 40 | | | | | |
| R | 461-500 | R | | 4 80 | | | | | |
| S | 501-540 | S | | 5 20 | | | | | |
| T | 541-580 | T | | 5 60 | | | | | |
| U | 581-620 | U | | 6 00 | | | | | |
| V | 621-660 | V | | 6 40 | | | | | |
| W | | W | | | | | | | |
| X | | X | | | | | | | |
| *Total cost of direct time* | | | | | | | | | |

Add — Allowance for unproductive time % ..................

Total time cost ..................

Overhead — % of total time cost ..................

Total time and overhead cost ..................

Profit — %..................

Direct expenses ..................

Total for billing ..................

Special factors considered ..................

Date ..................195 Approved by ..................

# Budgets for Canadian Business

By A. Gordon Hall, C.A.

**Most Canadian businesses have yet to install a budget system — a most valuable tool of management**

MOST businesses are operated with one purpose in mind and that purpose is to make profits. From the shareholders' point of view these profits should be as large as possible and in all cases at least reasonable in amount when compared with the amount of capital invested. Any device which will assist a business in achieving this objective is worthy of serious consideration. A well-managed budget system is one such device.

Some large Canadian businesses have recognized the merits of budgets and now operate with them. However, most Canadian businesses have not yet seen fit to install budget systems. The fact that so many do not use this valuable management tool would seem to be due to widespread human resistance to making any change from established procedures. Perhaps it is also due to a lack of knowledge of budgets and of their benefits when applied to business.

The purpose of this article is to review in a concise manner the principal benefits to be derived from a budgetary control system as applied to a business. Because these benefits are well known to persons experienced in the use of budgets, I have not written with such persons in mind, but rather directed my remarks at those readers whose practice or position does not take them into frequent contact with budgets.

The benefits to be derived from the use of budgets have been summarized under the following four headings:

1. to provide a guide and target,
2. to encourage planning and correlation,
3. expense control,
4. cash and capital expenditure budgets.

### 1. To Provide a Guide and Target

In most companies, including those using budgets, a comparison of the operating results with those of the previous year provides a good guide as to what is happening in the current year. Unfortunately the value of a "this year-last year" comparison may be reduced by a great number of factors of which the most important are:—

#### (1) *Poor Results in the Previous Year*

If the operations for the previous year resulted in a loss or a very low profit, there can be no great satisfaction in using these results as a yardstick and saying "Well, the results are not quite as bad

as last year." Similarly, sales are not necessarily satisfactory merely because they are higher than in the previous year.

A comparable situation may exist in regard to expenses. As an example, let us presume that a new plant was opened by a company in the previous year and expenses were high because of the general problems of starting up, cost of unskilled labour, etc. As manager of the company, would you be satisfied if the unit production costs in the second year of operation were about equal to those of the first year? Similarly, in a plant where the number of units produced had doubled, would you be satisfied if unit costs were about equal to those of last year?

### (2) *Very Good Results in the Previous Year*

The results for the previous year may have been particularly favourable because of market conditions which do not exist in the current year. In the years ahead not many companies are likely to find the demand for their products exceeding their ability to produce as has frequently happened in the past few years.

### (3) *Organizational Changes*

When changes in an organization take place, the responsibility for certain activities passes from one executive to another. At the same time the responsibility for incurring expenses changes, and the departmental comparison of expenses with last year may not always be made properly.

### (4) *Changes in the Methods of Operation*

Changes in the method of operation often make a comparison with last year difficult. Three examples of such changes which take place from time to time in most businesses are:

(a) transfer of operations from rented premises to a company's own building,

(b) use of rented trucks in place of a company's own trucks,

(c) installation of new modern machinery.

### (5) *Product and Market Changes*

From time to time changes are made in the products of a company and also of its competitors. Frequently new inventions or products reduce the market available for a company's products.

On the other hand the demand for a certain product may increase very substantially for the industry as a whole. The television industry is a good example of a rapidly expanding industry. Under such circumstances the executives of any particular company who are pleased with a small increase in sales over last year should be reminded that their company is actually losing out competitively.

### (6) *Changes in the Rate of Expenses*

The cost of most materials, supplies, and services fluctuates. As an example, wage rates are being increased from year to year and the hours of work are being reduced. A comparison of wage costs with those of last year either by amount or unit of production can only be made if this factor is taken into consideration.

### (7) *Accounting Changes*

From time to time changes are made in the accounting routines of a company to meet changing conditions. Each change renders more difficult a proper "this year-last year" comparison.

The purpose of listing the defects of a "this year-last year" comparison is not to belittle such a comparison, but rather to indicate the need for something extra. This extra is a budget.

Normally a budget is based on the experience of previous years but is adjusted for all the known change factors in the

coming year or other fiscal period. While we hear much about using engineered standards in setting budgets, the fact remains that in preparing all budgets, including those making some use of engineered standards, heavy weight is given to the results of the past. The only exceptions are completely new businesses where there is no previous experience.

A person reading an actual-budget comparison report knows that in most cases his guide has been prepared after recognition has been given to all known changes. He is thus able to examine his comparison without trying to keep in mind a number of change factors. The budget provides the guide or target at which to shoot. Just as an ocean liner is equipped with a compass so that the captain and his crew may direct the vessel towards its planned destination, a business should be equipped with a budget to assist the management in directing its operations towards a planned destination or target for the year — a satisfactory profit.

The setting of a sales volume target will keep the sales division of a company always working towards a planned volume of business. Instead of merely trying to better the results of the previous year or of aiming at sky-high sales quotas, the sales division is trying to achieve a reasonably planned objective. Normally this tends to produce extra sales and consequently extra revenue.

At the same time the expense budgets show the amounts available for each type of expense for sales, production, administration, etc. All department heads know how much money they have to spend in carrying out their responsibilities.

The comparison of the actual results with the budget indicates the degree of success in hitting the target. The comparison also shows where any deviations or variances from the target are taking place and thus indicates to management the matters calling for special attention.

**Mr. A. Gordon Hall, C.A. is assistant treasurer of Dow Brewery Limited, Montreal. He joined this firm in 1948 and was promoted to his present position in 1950. Previously he was with Montreal accounting firms and a corporation income tax assessor with the Department of National Revenue. He is a member of the Quebec Institute, having obtained his degree in 1943, and is also a member of the National Office Management Association.**

### 2. To Encourage Planning and Correlation

The executives of most firms receive the reports of a month's operations along about the latter half of the following month. The reports show what has been done. Unfortunately it is far too late to do anything about the month that has passed and even very much about the current month. When budgets are prepared, management is forced to think, not in terms of the past but of the future. Management must estimate the probable future sales, the cost of producing those sales, and the other expenses of carrying on the business. It is impossible to estimate future sales and expenses without doing a considerable amount of constructive thinking about the future.

The successful operation of any business requires some planning for the future. In a small business the planning is generally on an informal basis and represents the intuition of the owner. In larger businesses various executives are responsible for the planning. The preparation of budgets puts the planning on a more formal and thorough basis, and in addition it forces busy executives who

are immersed in the problems of the current moment to devote a certain amount of time to thinking about the future.

Many businessmen state that they are not able to forecast their future sales because of extreme fluctuations in their business. It is true that the volume forecast is often very difficult to make, but that is no excuse for not trying. Skill in making the forecast is developed with experience. Naturally the degree of accuracy of the sales forecast affects the efficiency of the company budget. A more important point is that, budget or no budget, the accuracy with which a businessman forecasts his future sales is one of the most important factors in his success or lack of it.

Having estimated the revenue to be received, we must then determine the costs required to produce the sales and the other expenses of running the company, showing the balance left as profits. If these forecasts do not indicate a satisfactory result, it is then possible for management to decide what steps are necessary to create satisfactory results. What expenses may be reduced? Is there any business being handled at a loss which should be eliminated? Should the proposed heavy sales and advertising campaign into a new area be delayed for a more suitable time? Many, many such questions must be discussed and decided before the budgets are approved. The final approved budget represents a correlated guide to the planned course of action to be followed in the year to come.

This procedure of preparing a correlated guide for all departments setting out the planned course of action is a most important matter. Maximum profits are achieved when all departments are pulling in the same direction towards a common objective. While we assume that all departments are naturally directed towards a common objective, a more thoughtful review of any business makes us realize that the interests of all departments in any company are not the same.

### The Compromise Point

To illustrate this point I would like to refer to the well known fact that any plant is operated at a higher degree of efficiency and with lower unit costs if the number of products and of sizes, shapes, colours, packaging, etc. is limited. It is an equally well known fact that most industries can normally increase sales by increasing the number of products and sizes, shapes, colours, packaging, etc. available for sale. Obviously these conflicting interests must be correlated or compromised at some point, and preferably at the point at which the company will earn the maximum profits.

Another factor to be contended with in larger companies is that occasionally some of the members of the management team tend to lose sight of the main objective of the company, namely, to make money. For instance, the sales manager in his desire to achieve the maximum possible volume of sales may solicit business which, because of its nature, price, or cost of obtaining, is unprofitable. The plant manager may want to make very extensive improvements, the cost of which is not justified at the time. Administrative and service departments may be extended beyond their economic justification. Particularly in good times many special activities are carried on which do not necessarily contribute to the profitable operation of the company. A proper balance must be determined for the various activities.

Budgets force management to think about such matters in advance and thus assist in the establishment of long-term policies. This helps to prevent frequent and often conflicting changes in policy resulting from decisions based on temporary conditions.

In addition, well prepared budgets provide much useful cost data to be used in studying various phases of a company's operations. Package profit contributions and sales area profit contributions are examples of information which is much more readily obtainable in firms using flexible budgets.

### 3. Expense Control

Expense budgets may be fixed or flexible so as to relate to the volume of business being handled. If on a fixed basis the unit cost comparison is generally of more interest than the total value, while in the case of flexible budgets the total variance is the important factor.

The expense budgets may be prepared monthly, quarterly, or annually depending on the procedures in use and the desired objectives. Generally speaking the shorter the period and the closer the time of budget preparation to the period being covered, the more effective the control becomes. Monthly budgets prepared a few days before the start of the month can be exceedingly close to the attained results. Operating personnel can be held accountable for relatively minor deviations from budgets set with a good knowledge of volume of business, number of working days, and special factors affecting the particular month. To budget carefully for the next month makes a department head think carefully about such factors as number of personnel, material requirements, etc. Thinking, not about past results but about future operations, is an important requirement in effective expense control.

Some expenses should not be budgeted for on a short term basis. Advertising is one expense for which it is very desirable to budget and plan on a longer term, such as one year. To increase or decrease an advertising budget from month to month based on the current feeling of optimism or pessimism would render impossible any effectively planned program. Research is another expense that should be budgeted and planned for on a long-term basis.

When the budget is being drawn up, the amount or rate that will be required for each type of expense is determined after adequate study, and these amounts are approved by management. Thus, the expenses are controlled at the only time that they can be controlled, which is before they are incurred. Any department head whose expenses exceed his budget must be ready with very good reasons to justify the excess expenditures to his superiors. In this way a good control is kept over expenses. A review of the actual expenses even when supplemented with a comparison of the expenses of the previous year is of only limited value because by the time the statements are being reviewed, the money has already been spent. While a person who has authorized excessive expenditures may be reprimanded for his actions, it is too late to recover the money which has already been spent.

While I have been emphasizing expense control as a means of preventing excess expenditures, there are occasions when the converse is desirable. In such cases management is more interested in obtaining the maximum benefit from the funds allocated than a less effective job even though accompanied by savings in a particular type of expense.

Expense budgets need not only be on a dollar basis. "Man hour" or "number of employee" budgets can have an effective place in controlling salary and wage costs. Quantities of materials may be budgeted per unit of production and compared with actual performance, with explanations required for variances.

### 4. Cash and Capital Expenditure Budgets

Frequently, when large companies en-

gage in an extensive program of capital expenditures a budget is prepared to set out the estimated expenditures and the method by which the projects are to be financed. Often such budgets are correlated with a general cash budget covering all the transactions of the company.

Even where no large capital expenditures are contemplated, some companies use cash budgets or source and application of funds budgets. Such budgets are very helpful in planning the financial affairs of a company including bank loans, investing surplus funds, etc.

### Conclusion

For many companies the period of easy profits is over. Although the economy is buoyant and the volume of business is good, profits are on the decline in many cases. Increased competition and increased costs, particularly wages, tend to force profit margins lower and lower. The better managed companies will continue to prosper, while many of the less organized will gradually disappear from the business scene or will merely manage to exist. In such times a business needs to define clearly, by means of a budget, what it is trying to achieve each year.

There is no guarantee of success merely because a company operates with a budget. The budget provides the guide to show what is probably going to happen or what management desires to have happen. When the forecast results are not satisfactory, management is faced with the task of taking the necessary correlative steps if it is able to do so. At least management is able to anticipate the trend of operations.

It need not be assumed that budgets can only be installed in relatively large companies. This is not so. Any business for which is prepared a monthly profit and loss statement is in a position to make use of at least a fixed profit and loss budget, which is in most cases the basic budget. Enlargement from here to budgets by cost centres and to flexible budgets is merely an extension of the basic budget. Like an accounting system, the budget for any company should be tailored to the needs of the concern.

For this reason no effort is made in this article to outline any recommended types of budgets. Each company should plan and develop from experience a budget best suited to its needs.

The operation of a budget system need not be costly. In fact, the cost of a well-managed budget is negligible in relation to the benefits that it can bring a business. If not well managed, the budget falls into the same category as any other business activity which is poorly managed.

Canadian business has not been quick to make use of this valuable management tool and there is a big educational job to be done in this respect. Chartered accountants are well qualified as a group to perform this task which could result in many satisfactory engagements for the practising members of our profession.

The task of selling budgets to the management of a company is not always an easy matter. Many people resist changes which alter their established methods or procedures. However, as business becomes more competitive it will become increasingly necessary for the management of each company to adopt the most effective tools available to help in the effective management of the company.

The day may well come when all well managed businesses will be equipped with budgets designed to help them achieve their logical targets — a satisfactory profit.

## Professional Notes

### QUEBEC INSTITUTE COUNCIL SUBMITS BRIEF TO QUEBEC ROYAL COMMISSION ON CONSTITUTIONAL MATTERS

On April 22, 1954 Council of the Quebec Institute submitted a lengthy brief to the Quebec Royal Commission on Constitutional Problems, confining its statement to Federal-provincial financial relations. The brief contains an elaborate survey of the subject since Confederation and is supplemented by an appendix of 20 exhibits. The Council's brief concludes with a suggestion for the solution of the problem which has arisen as a result of the imposition of a personal income tax by the Quebec Legislature this year. Follows the concluding paragraphs of the brief:—

Under the existing conditions, six of the ten Provinces would have difficulty in collecting from local sources the equivalent of payments now made to them by the Federal Government, and the other four with greater wealth and resources could finance without assistance from the Federal Government. For convenience, the 1952-53 tax rental payments, including provision for Quebec, are grouped below under these two categories:

| | Payments for 1952-3 (*Millions of Dollars*) | |
|---|---|---|
| **GROUP I** | | |
| **Provinces requiring Federal assistance** | | |
| Newfoundland | 12.3 | |
| Prince Edward Island | 3.9 | |
| Nova Scotia | 20.2 | |
| New Brunswick | 16.6 | |
| Manitoba | 24.7 | |
| Saskatchewan | 25.6 | |
| | | 103.3 |
| **GROUP II** | | |
| **Provinces not requiring Federal assistance** | | |
| Quebec | 115.0 | |
| Ontario | 137.2 | |
| Alberta | 29.4 | |
| British Columbia | 41.4 | 323.0 |
| | | 426.3 |

If Quebec signed an agreement, the Federal Government would be faced with the necessity of collecting and redistributing to the Provinces $426.3 million each year (1952-53 basis) and possibly larger sums until 1957 if the population and gross national product of Canada continue to increase.

For 1953-54, budget revenues of Canada from income taxes and succession duties are estimated at $2,518 million[1]. The gross amount of the rental payments, $426.3 million, includes compensation for succession duties, but since Ontario and Quebec levy their own duties, the actual payments are reduced by the credits allowed to taxpayers in these Provinces and estimated to aggregate $21.0 million for 1952-53. The net amount of $405.3 million (i.e. 16.1% of the above budget revenues) would be required to service the tax rental agreements including Quebec. Of this amount $302.0 million, or 12.0% of the $2,518 million mentioned above, is in respect of the four wealthier Provinces and only $103.3 million, or 4.1%, of the six others.

As a result of our study of the foregoing facts, the following conclusions are drawn:

[1] Hansard, Feb. 19, 1953, p. 2134 and Exhibit 8.

1. In principle, the Federal Government should not raise revenues from residents of a certain Province in order to distribute these same revenues to the government of that Province for the purpose of paying for services for which that provincial government is responsible.
2. Where a provincial government is able to raise revenues to pay for provincial public services, such revenues should be collected directly from its own residents.
3. It is recognized that under existing conditions certain provincial governments are unable to raise from their residents adequate revenues to meet the obligations for which they are responsible.
4. It is in the interests of the more fortunate Provinces, as well as Canada as a whole, that the less fortunate Provinces should receive assistance from the Federal Government. This assistance should be kept to a minimum by such Provinces imposing on their own residents taxes to the maximum possible extent having regard to the level of taxation being imposed by the Federal Government.

In the light of these conclusions, it is recommended that:

1. The 1952 tax rental agreements between the Federal Government and the Provinces of Ontario, Alberta, and British Columbia be not renewed in 1957.
2. In 1957 a new arrangement be made between the Federal Government and those Provinces not desiring to re-enter the corporation income tax, personal income tax, and succession duty fields, except to the extent stated below (in 3), this arrangement to be based on the tax rental payments received by such Provinces during the last year of the present agreements and subject to annual review for increases in population and gross national product.
3. Those Provinces executing new agreements with the Federal Government in 1957 should levy a provincial corporation tax and a provincial personal income tax. Collections under these levies should be offset against amounts payable to each of those Provinces under its agreement.
   The rates for the levies should be uniform throughout the agreeing Provinces and should be determined at reasonable levels appropriate to their taxable capacity.
   For 1957 and thereafter, the corporation and personal income taxes levied by these or any other Provinces would not be deductible by taxpayers from the corresponding Federal levies.
4. The Federal Government reduce federal levies for corporation and personal income taxes in 1957 by an amount equivalent to an aggregate of the following:
   (a) Rental payments to Ontario, Alberta, and British Columbia in 1956;
   (b) Relief granted in respect of Quebec corporation and personal income taxes in 1956;
   (c) Estimated amount of corporation and personal income taxes collectible on behalf of the remaining six Provinces in 1957.
5. In order to reduce the costs of collection and compliance—
   (a) The present tax collection machinery of the Federal Government be used in the future as it has at times in the past to collect provincial corporation and personal income tax levies;
   (b) The Federal and provincial Acts and Regulations be made as uniform as possible.
6. The Dominion succession duty rates and the provision for credits for provincial duties up to 50% of the Federal duty should remain as now existing.
7. Taxpayers in Quebec during the years 1954 to 1956—
   (a) continue to deduct provincial corporation income tax at present rates from the corresponding Federal levy, and
   (b) be permitted to deduct the full pro-

vincial personal income tax from the corresponding Federal levy (provided these deductions do not exceed the amount the Provincial Government would have received from the Federal Government by signing a tax rental agreement).

If recommendation 7 is not acceptable to the Federal Government, we recommend that, in order to terminate the present unsatisfactory situation of taxpayers in this Province, the two governments concerned should execute a tax agreement until 1957 on a mutually acceptable basis.

The recommendations do not envisage the appointment of any Board or Commission to determine the grants payable to the less fortunate Provinces the existing formula can still be utilized.

In the event of a major war or depression it may again be desirable for the Federal authority to have sole access to the corporate income tax, the personal income tax, and the succession duty fields. It is believed that such emergencies should be dealt with as they arise, but that otherwise fiscal policies of the Federal Government and the Provinces should be determined on the basis of a peace-time economy.

* * * * *

## NEWS FROM THE C.I.C.A.

### Committee on Recruitment and Training

A two-day meeting was held on April 21 and 22 under the chairmanship of T. C. Kinnear, F.C.A. to consider recommendations on recruitment and training which the committee will be presenting in a forthcoming report to the executive and Council of the C.I.C.A.

### Committee on Co-operation with Other Accounting Bodies

The committee under the chairmanship of C.I.C.A. president Walter J. Macdonald met in Toronto on April 5.

### Board of Examiners-in-Chief

The Board of Examiners-in-Chief, under the chairmanship of J. M. Moynes, C.A., met on April 5, 6, and 7 at Mont Gabriel Lodge, P.Q. to review the drafts of the 1954 uniform intermediate and final examinations.

## BRITISH COLUMBIA

Mr Dennis F. Culver, C.A., announces the opening of an office for the practice of his profession at 400 Alaska Pine Bldg., 1111 W. Georgia St., Vancouver.

* * *

Mr J. J. Plommer, C.A. announces the removal of his office to Ste. 305, 402 W. Pender St., Vancouver.

O'Brien, Manzer & Co., Chartered Accountants, announce the removal of their office to 102 Crown Bldg., 615 W. Pender St., Vancouver.

## ONTARIO

Mr Arthur M. Hunt, C.A. announces the removal of his offices to Ste. 512, McKinnon Bldg., 19 Melinda St., Toronto.

### Hamilton and District C.A. Association

On Thursday, April 22, 1954, the fourth annual joint dinner meeting of the Hamilton Control of the Controllers Institute of America and the Hamilton and District Chartered Accountants' Association was held at the Royal Connaught Hotel in Hamilton.

Dr W. A. Mackintosh, C.M.G., Ph.D., LL.D., F.R.S.C., principal and vice-chancellor of Queen's University, addressed the meeting on "What is Ahead for the Canadian Economy". Chancellor Gilmour of McMaster University welcomed and introduced the speaker.

Dr Mackintosh arrived at an optimistic outlook for the future Canadian economy which, although subject to some unavoidable variations, should not experience a severe depression. R. B. Taylor was chairman.

* * *

Mr Sidney S. Ross, C.A. announces the removal of his offices to Ste. 5, 233 Spadina Ave., Toronto.

### Ontario Students Association

The 1953-54 annual meeting or the Ontario Students Association was held on May 4, 1954 at the 48th Highlanders Hall, Toronto. William Bradshaw, retiring president, was chairman of the meeting which drew approximately 80 members. Over 300 students voted in the annual election and this represented somewhat of a record for recent years. The members elected were — Walter Gregory, C.A., Joseph Harper, C.A., William A. Bradshaw, William H. Broadhurst, J. Donald Crump, Glenn D. J. Grossett, Miles H. Kennedy, John P. McCarter, Roderick J. Whitehead, and Reid D. Williamson.

Mr W. M. Brace, F.C.A., vice-president of the Institute of Chartered Accountants of Ontario, was the guest speaker for the evening.

### C.A. Club of Western Ontario

Two interesting speakers were heard by the members of the Chartered Accountants Club of Western Ontario at their regular monthly meeting, March 30, at the Catholic Culture Centre in London.

Mr T. Cadham, a graduate of Harvard School of Business and now on the staff of John Labatt Limited, reviewed the various types of profit-sharing plans operating in corporations in North America.

Mr R. W. Porter, a graduate of the University of New Brunswick and now London Manager of the Standard Life Assurance Company, cited the advantages of pension plans as offered by insurance companies in comparison with profit-sharing for employees, the benefits accompanying a modern pension plan, and its flexibility to meet the needs of the individual corporations.

Mr R. G. Brownridge was chairman of the meeting.

* * *

Norman B. McLeod & Co., Chartered Accountants, announce the removal of their offices to Rm. 1326-8, Montreal Trust Bldg., 67 Yonge St., Toronto.

* * *

Mr Kenneth W. Ball, C.A. announces the admission to partnership of Messrs George R. Wallace, C.A. and E. F. Smith, C.A. Practice of the profession will be carried on under the firm name of Kenneth W. Ball & Co., Chartered Accountants, with offices at 44 King St. W., Toronto.

### QUEBEC

Deloitte, Plender, Haskins & Sells, Chartered Accountants, announce the removal of their Montreal offices to the Canadian Pacific Express Bldg., 215 St. James St. W., Montreal.

## News of Our Members

At the behest of Sir Hugh Mackintosh Foot, governor-in-chief of Jamaica, Mr Percy Black, C.A. (Que.), recently collaborated with Mr John W. Yaxley, Montreal industrialist, in the investigation into certain difficulties in the Jamaican textiles situation. Their report entitled "A Report on the Cotton Textiles Production, Marketing, and Imports of Jamaica, January-March 1954", has been forwarded to A. M. W. Douglas, Minister of Trade and Industry, Kingston.

* * *

Rapid Grip & Batten Ltd., Toronto, announce the appointment of Mr D. R. Keedwell, C.A. (Ont.), as secretary-treasurer and a director.

Mr Leon Bennet-Alder, C.A. (Ont.), has been appointed superintendent of Victoria General Hospital, Winnipeg.

* * *

Mr Gordon W. Hunter, C.A. (Man.), has been named assistant deputy minister of the Defence Production Department, effective May 1.

* * *

Mr W. F. Davey, C.A. (Que.), has been appointed general manager of Winnipeg and Central Gas Company.

* * *

Canadian Aviation Electronics Ltd., Montreal, announces the appointment of Mr. W. M. Chamard, C.A. (Que.), as treasurer.

# Accounting Research

By Gertrude Mulcahy, B.A., C.A.
The C.I.C.A. Research Department

## INVENTORIES

THE term "inventories" means the stock of merchandise purchased for resale, materials and supplies purchased for use in production, and finished or partly finished goods manufactured or produced for sale.

In recent years greater emphasis has been put on the determination and valuation of inventories than on almost any other item of the financial statements. This is understandable in view of the significance of inventories in determining both the profits from operations and the current working capital position of a concern.

In addition to setting forth recommendations as to statement presentation, the Committee on Accounting and Auditing Research of the Canadian Institute of Chartered Accountants has issued two bulletins dealing specifically with inventories, namely Bulletin No. 5, "The Meaning of the Term 'Cost' as Used in Inventory Valuation" and No. 7, "The Auditor's Responsibility for the Validity of the Inventory Figure".

### Disclosure of Subdivisions of the Inventory

Of the financial statements analyzed for the years 1952, 1951, 1950, and 1949, 40, 32, 27 and 33, respectively, set out in the balance sheet the dollar value applicable to each subdivision of the inventory. The extent to which such disclosure is advisable depends on the circumstances of each particular concern. In the financial statements mentioned above it was impossible to determine the intention, if any, of the disclosure of the dollar values of the various subdivisions of the inventory. It was not apparent whether such detail was presented merely because such had been done in the past or to indicate an unusual situation in the company's inventory position.

The disclosure of the values given to the various components of the inventory, as set out in example 1, does not, in itself, give the reader any information. A review of this company's statements of the 1951 and 1950 years shows that while the value of the total inventory fluctuated moderately from year to year, the ratio of the value of the various components to the total was constant for all practical purposes.

Many of the financial statements indicated the components of the inventory figure by the use of such captions as "Inventories of raw materials, supplies, work in process and finished goods" without disclosing the dollar

value attributable to each. (See example 2)

### Basis of Valuation

Although the majority of the financial statements adhered, in some form or other, to the requirements of the Companies Act, 1934 (Canada) and to the recommendations relating to the disclosure of the basis of inventory valuation which are contained in Bulletin No. 1, 16 in 1952, 16 in 1951, 10 in 1950, and 8 in 1949 failed to give any such information. (See example 3)

From figure 1, which classifies the various bases of valuation disclosed in the financial statements, it is apparent that the "lower of cost or market" continues to be the generally accepted basis of inventory valuation in this country. (See also examples 1 and 2)

The miscellaneous category includes such descriptions as "approximate cost", "lower of approximate cost or market", "estimated cost", "market", "average cost or market, whichever is lower", and "lower of cost of materials and direct labour or market".

In Bulletin No. 1, the Committee on Accounting and Auditing Research recommended that the basis of valuing inventories be clearly disclosed. The following descriptions appearing in the 1952 financial statements do not describe any basis of valuation and if interpreted literally would permit wide fluctuations in value: "at not more than cost", "cost or under, not more than market", "on a basis which in total does not exceed the lower of laid down cost or market", "on a conservative basis and not more than replacement cost", etc. (See example 4)

Little or no reference has been made to the methods used in determining inventory "cost".

A few statements indicated that the basis of the current valuation of inventory had changed from that used in previous years. Examples 5 and 6, taken from 1952 financial statements, clearly disclose the impact of such a change on the current financial statements.

### Determination and/or Certification of Inventory Figure

In recent years there has been considerable discussion both for and against including in the balance sheet a specific reference to the manner in which the inventory has been determined. It has been argued that such a reference may be interpreted as an indication that the auditor does not accept full responsibility for the inventory figure. However, the Committee on Accounting and Auditing Research is of the opinion that "the inclusion in the balance sheet of the words 'as determined and certified by management' or words of similar import with reference to the inventory does not relieve the auditor of respon-

*Figure 1*

| 1952 | 1951 | 1950 | 1949 | Basis of valuation disclosed |
|---|---|---|---|---|
| 65% | 63% | 59% | 60% | — Lower of cost or market |
| 10% | 10% | 15% | 9% | — Cost, factory cost, production cost |
| 2% | 3% | 3% | 3% | — Market |
| 23% | 24% | 23% | 28% | — Miscellaneous |
| 100% | 100% | 100% | 100% | |

*Figure 2*

| 1952 | 1951 | 1950 | 1949 | Disclosure of manner of determining inventory |
|---|---|---|---|---|
| 33% | 37% | 41% | 42% | — as determined and certified by management and/or officials of the company |
| 9% | 11% | 11% | 15% | — as certified by management and/or officials of the company |
| 3% | 4% | 3% | 5% | — as determined by management and/or officials of the company |
| 4% | 4% | 5% | 3% | — as determined or certified by management based on physical count |
| 10% | 7% | 11% | 10% | — miscellaneous |
| 59% | 63% | 71% | 75% | |
| 41% | 37% | 29% | 25% | — not stated |
| 100% | 100% | 100% | 100% | |

sibility" but "can only be regarded as a part of the financial statements presented by the directors and designed to comply with the provision of section 112(2)(d) of the Company's Act, 1934 (Canada)".

From figure 2, it is apparent that although the majority of the financial statements disclose the manner of determining the inventory, an increasing number of financial statements do not contain such a reference. Included in the miscellaneous category of figure 2 are such descriptions as "as approved by the management and/or officials of the company", "as valued by the management and/or officials of the company", "determined by physical count", and "based on the company's records and physical count".

### Inventory Reserves

Of the financial statements analyzed, 86 in 1952, 83 in 1951, 70 in 1950, and 68 in 1949 indicated the existence of an "inventory reserve". Figure 3 shows that the majority of the statements set out the dollar value of the inventory reserve. Few of the statements setting out the inventory reserve on the liabil-

*Figure 3*

| 1952 | 1951 | 1950 | 1949 | Disclosure of Inventory Reserves |
|---|---|---|---|---|
| 42% | 41% | 37% | 38% | — Reserve set out on liability side of balance sheet |
| 10% | 14% | 13% | 16% | — Reserve set out as a deduction from the inventory figure |
| 21% | 16% | 10% | 12% | — Reserve set out in description of inventory |
| 27% | 29% | 40% | 34% | — Reserve referred to in description of inventory, but amount thereof not disclosed |
| 100% | 100% | 100% | 100% | |

ity side of the balance sheet included such item in the shareholders' equity section. Since many of the 1952 financial statements had been prepared prior to the release of Bulletin No. 9, the impact of the recommendations contained in that bulletin will not be evident until future years.

In many of these financial statements (35 in 1952) the reserve is stated specifically to be in respect of a future decline in inventory values. In most of the other cases the items are described simply as "reserves". Accountants would assume that these "reserves" were true reserves as defined by Bulletin No. 9. However, in a number of cases such reserves appear on financial statements in which the accumulated depreciation and the allowance for doubtful debts are also described as "reserves". In these circumstances the reader is forced to make his own interpretation of the meaning of the term "reserve". Confusion may also arise where the inventory reserves are described as "inventory valuation reserve", "allowance for obsolescence", "reserve in respect of a normal quantity of inventories", "reserve for inventory contingencies".

Examples 1, 2, 4, 5, and 6 illustrate the variations in practice in this respect. Examples 6 and 7 are out of the ordinary in that they show two reserves against inventories.

**Example 1**

| | | |
|---|---|---|
| **Current assets** | | |
| Valued at the lower of cost or market | | |
| Corn | $2,011,024 | |
| Goods in process | 113,334 | |
| Finished goods | 941,986 | |
| Manufacturing supplies | 477,062 | |
| Mechanical stores and replacement parts | 340,022 | $3,883,428 |
| **Capital stock, reserves and surplus** | | |
| Reserve for future depreciation in inventory values | | 250,000 |
| Reserve for corn | | 300,000 |

**Example 2**

| | |
|---|---|
| **Current assets** | |
| Inventories of raw materials, goods in process, finished goods and factory supplies, based on quantities certified by the management, valued at the lower of cost or market | $4,091,971 |
| Less inventory reserve | 150,000 |
| | $3,941,971 |

**Example 3**

| | |
|---|---|
| **Current assets** | |
| Newsprint, pulpwood, stores, etc., including woods operation and advances on pulpwood contracts | $4,615,243 |

**Example 4**

| | |
|---|---|
| **Current assets** | |
| Inventory of merchandise and supplies as determined and certified by the management and valued on a basis which in total does not exceed the lower of laid-down cost or fair market value, less reserve of $280,000 for future depreciation in values | $10,040,162 |

### Example 5

**Current assets**

| | |
|---|---|
| Inventories of wire cloth, wire, etc., valued at the lower of cost or market | $1,187,147 |

**Capital stock, reserves and surplus**

| | |
|---|---|
| Reserve for future decline in inventory values | $ 258,000 |

**Statement of earned surplus**

| | |
|---|---|
| Appropriations for reserves | |
| Inventories | $ 35,000 |

**Directors' Report**

Following the practice adopted last year, the company's inventories as of March 31, 1952, have been valued so as to comply with Government rulings under recent Income Tax Regulations. Pending a final decision as to the validity of these rulings, your directors have again considered it prudent to appropriate a sum equivalent to the net adjustment as a reserve for future decline on inventory values.

### Example 6

**Current assets**

| | |
|---|---|
| Inventories, valued at lower of cost or market, less reserve, comprising raw materials and supplies, goods in process and finished products, and logging and pulpwood advances season 1952-53, as certified by responsible officials of the companies | $13,183,893 |

**Statement of Consolidated Income and Expenditure**

| | |
|---|---|
| Before net figure | |
| Applied in reduction of pulpwood inventories due to change in method of establishing costs | $ 833,272 |

**Directors' Report**

It has been deemed advisable, due to the continued increase in the cost of producing pulpwood, to change the method of charging pulpwood to manufacturing costs from the actual cost of pulpwood consumed to the approximate average cost of inventory at the first of the year and pulpwood cut and contracted for during the year. As a result of this change, charges to manufacturing costs have been increased in 1952 by $833,272 and the valuation of pulpwood inventories has been reduced by an equal amount.

### Example 7

**Current assets**

| | | |
|---|---|---|
| Inventories | | |
| Malt, barley, etc., valued at the lower of approximate cost or market, less reserve | $10,799,144 | |
| Operating supplies at cost | 317,253 | $11,116,397 |

**Liabilities**

| | | |
|---|---|---|
| Reserve against future decline in inventory values | | $ 600,000 |

# The Students' Department

**J. E. Smyth, C.A., Editor**
(*Correspondence with the editor is cordially invited*)

## NOTES AND COMMENTS

IN times past when published financial statements have chanced to come within the range of our scrutiny a dark look would come over us and we have been heard to mutter things under our breath. But this year all is different. We have been looking at a few recent annual reports and the other day we were caught smiling pleasantly while doing so. Our step is lighter this year, and our head is higher; we look with confidence to the future.

For example, we have at last found a reserve against future decline in inventory values in its proper place on a balance sheet — as a part of shareholders' equity. (The balance sheet is that of G. Tamblyn, Limited as at December 31, 1953.) This treatment of the reserve clearly shows the influence of Bulletin No. 9 of the Committee on Accounting and Auditing Research of the Canadian Institute; that bulletin recommends that use of the term "reserve" be restricted to appropriations of retained earnings and refers specifically to a reserve against future decline in inventory values as being such a reserve.

The so-called "funds statement", too, seems to be coming into its own. In two of the annual reports of oil companies which have come to our attention an analysis of working capital is not only presented, but the term "working capital" is used instead of "funds" — the latter being a term which seems to mean many things to different people. At least there is fairly general agreement in accounting circles about the meaning of working capital; though we must admit we have heard of those who define working capital as merely the total of current assets, and not as the excess of current assets over current liabilities (which they choose to call *net* working capital), and of others who like to exclude inventories and prepaid expenses. Still, the term "working capital" is more precise than "funds".

The annual report of McColl-Frontenac Oil Company Limited shows the "source and use of working capital" in comparative form for the past five years. Further, it shows working capital at the beginning of each year, adds the sources, deducts the applications, and arrives at the working capital at the end of the year. This presentation is to our mind preferable to showing merely the sources and uses and their difference. Even when there is an increase in working capital, not all the applications need have been made out of the very working capital which became available dur-

ing the year in question; some part (one cannot tell how much) may as well have been an application of the working capital as of the beginning of the year.

The annual report of British American Oil Company Limited for 1953 also provides an analysis of working capital for the five years 1949-53 inclusive under the headings "Working capital received" and "Working capital disbursed".

Of the three annual reports mentioned, two avoid the much misunderstood term "surplus" on the balance sheet. The balance sheet of G. Tamblyn, Limited refers to "earnings employed in the business" and the balance sheet of British American Oil Company Limited describes the item as "retained earnings".

Of course we realize our sample of annual reports is not representative, and that there are still many bad — or should we be constructive and say improvable? — financial statements extant. But we trust readers will not spoil our present mood by sending us examples.

## PUZZLE

This division problem has a unique solution; every dash indicates a number.

```
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```

(Submitted by Mr. Stanley Tench, Vancouver in response to the editor's request for more puzzles.)

## SOLUTION TO THE PUZZLE FOR MAY

Let "x" dollars = the amount of Jones' bonus.

Then $10x = (100\% - 49\%) \text{ of } (38{,}000 - x)$

$$10x = \frac{51}{100}(38{,}000 - x)$$

$$1{,}000x = 1{,}938{,}000 - 51x$$

$$1{,}051x = 1{,}938{,}000$$

$$x = 1{,}843.96$$

The amount of the bonus was $1,843.96

Proof:

| | |
|---|---:|
| Profit (before bonus and income tax) | $38,000.00 |
| Deduct bonus | 1,843.96 |
| Profit (before income tax) | 36,156.04 |
| Deduct income tax (49%) | 17,716.46 |
| Profit for year | $18,439.58 |

## PROBLEMS AND SOLUTIONS

Solutions presented in this section are prepared by qualified accountants and reflect the personal views and opinions of the various contributors. They are designed not as models for submission to the examiner, but rather to provide such discussion and explanation of the problems as will make their study beneficial. The editor will welcome discussion of the solutions published.

### PROBLEM 1

### Intermediate Examination, October 1953

*Accounting I, Question 3 (15 marks)*

The following are the totals in the cash book of C Groceteria for the year ended 30th November 1952:

**C GROCETERIA**
**CASH BOOK**
**as at 30 Nov 1952**

| | Dr. | Cr. |
|---|---|---|
| Cash totals | $174,250 | $176,910 |
| Bank loan | 8,000 | 6,000 |
| Sales | | 168,250 |
| Salaries and wages | 8,160 | |
| Freight and express | 4,610 | |
| Interest | 530 | |
| Insurance | 850 | |
| Advertising | 140 | |
| Office expense | 750 | |
| Light, heat, and water, etc. | 360 | |
| Taxes | 530 | |
| Purchases | 147,700 | |
| Drawings | 4,800 | |
| Repairs and maintenance | 480 | |
| | $351,160 | $351,160 |

The following information is applicable:

(a) There is no general ledger.

(b) Assets and liabilities as at 30 Nov 1951 were:

| | | |
|---|---|---|
| Cash on hand and in bank | $ 9,000 | |
| Accounts receivable — trade | 15,500 | |
| Merchandise inventory | 27,000 | |
| Furniture and equipment | 3,700 | |
| Building | 6,350 | |
| Land | 250 | |
| Bank loan payable | | $ 6,000 |
| Accounts payable — trade | | 29,000 |
| — other | | 1,300 |
| | 61,800 | 36,300 |
| Net worth | | 25,500 |
| | $61,800 | $61,800 |

(c) Accounts payable as at 30 Nov 1951 and 30 Nov 1952 were as follows:

| | 30 Nov 1951 | 30 Nov 1952 |
|---|---|---|
| Trade | $29,000 | $18,300 |
| Freight | 450 | 240 |
| Salaries | 500 | 300 |
| Taxes | 100 | 150 |
| Office | 60 | |
| Light | 40 | 60 |
| Interest | 50 | 100 |
| Insurance | 100 | 50 |
| Income tax deductions | | 90 |

(d) Trade accounts receivable as at 30 Nov 1952 amounted to $12,000.

(e) Inventory as at 30 Nov 1952 was valued at $32,000.

(f) Fixed assets are shown at net book value and depreciation should be provided at 20% on furniture and 10% on building.

**Required:**

(9 marks) (a) Statement of profit and loss for the year ended 30 Nov 1952.

(6 marks) (b) Balance sheet as at that date.

## A SOLUTION

### C GROCETERIA

### Statement of Profit and Loss

**for the year ending 30 Nov 1952**

| | | | |
|---|---|---|---|
| Sales | | $164,750 | |
| Cost of goods sold | | | |
| Inventory 1 Dec 1951 | $ 27,000 | | |
| Purchases | 137,000 | | |
| | 164,000 | | |
| *Less* inventory 30 Nov 1952 | 32,000 | 132,000 | |
| Gross profit | | | $ 32,750 |
| *Less* operating expenses . | | | |
| Freight and expenses | 4,400 | | |
| Salaries and wages | 8,050 | | |
| Interest | 580 | | |
| Insurance | 800 | | |
| Advertising | 140 | | |
| Office expense | 690 | | |
| Light, heat and water | 380 | | |
| Taxes | 580 | | |
| Repairs and maintenance | 480 | | |
| Depreciation — buildings | 635 | | |
| — furniture and equipment | 740 | | 17,475 |
| Net profit from operations | | | $ 15,275 |

C GROCETERIA

BALANCE SHEET

as at 30 Nov 1952

ASSETS

| | | |
|---|---|---|
| **Current assets** | | |
| Cash on hand and in bank | $ 6,340 | |
| Trade accounts receivable | 12,000 | |
| Inventory, at the lower of cost or market | 32,000 | |
| Total current assets | | $50,340 |
| **Fixed assets** | | |
| Land, at cost | 250 | |
| Building, at cost less recorded depreciation to date | 5,715 | |
| Furniture and equipment, at cost less recorded depreciation to date | 2,960 | |
| Total fixed assets | | 8,925 |
| | | $59,265 |

LIABILITIES AND PROPRIETORSHIP

| | | |
|---|---|---|
| **Current liabilities** | | |
| Trade accounts payable | $18,300 | |
| Other accounts payable | 990 | |
| Bank loan | 4,000 | |
| Total current liabilities | | $23,290 |
| **Proprietorship** | | |
| Balance 30 Nov 1951 | 25,500 | |
| *Add* profit for year | 15,275 | |
| | 40,775 | |
| *Deduct* drawings | 4,800 | |
| Balance 30 Nov 1952 | | 35,975 |
| | | $59,265 |

## *EXAMINER'S COMMENTS*

One of the most common omissions from candidates' solutions was a reference to the basis of valuation of inventories and fixed assets.

## PROBLEM 2

### Final Examination, October 1953

*Accounting I, Question 5 (20 marks)*

As treasurer of the U Manufacturing Co. Ltd. you have drawn up the following budget covering anticipated operations for the month of September 1953:

| | | |
|---|---|---|
| Sales — 1,500 units at $150 each | | $225,000 |
| Cost of sales | | |
| Opening inventory 100 units at $110 each | $ 11,000 | |
| Production 1,700 units at $110 each | 187,000 | |
| | 198,000 | |
| Closing inventory 300 units at $110 each | 33,000 | 165,000 |
| | | $ 60,000 |

The company operates a standard cost system in which all inventories are carried at standard. The standard cost per unit has been established as follows on a normal production of 1,700 units per month:—

| | |
|---|---|
| Material 20 lbs. at $2.00 per lb. | $ 40.00 |
| Labour 20 hrs. at $1.25 per hr. | 25.00 |
| Factory service expenses $2.25 per direct labour hour | 45.00 |
| | $110.00 |

Actual operations for the month of September 1953 resulted in the following:

| | | |
|---|---|---|
| Sales 1,600 units at $140 each | | $224,000 |
| Material purchased 32,500 lbs. at $2.05 per lb. | | 66,625 |
| Direct labour 34,700 hrs. at $1.20 per hr. | | 41,640 |
| Actual factory service expense | | 78,735 |
| Units put into production | 1,750 | |

Inventories were:

| | 1 Sept 1953 | 30 Sept 1953 |
|---|---|---|
| Raw material at standard | 8,000 lbs. at $2.00 | 6,000 lbs. at $2.00 |
| Work in process — material | 100 units 100% complete | 200 units 75% complete |
| Work in process — labour | 100 units 50% complete | 200 units 40% complete |
| Work in process — factory service | 100 units 50% complete | 200 units 40% complete |
| Finished goods | 100 units at $110 | 150 units at $110 |

**Required:**

An analysis of all variances from standard and budget classified as to price, volume, usage or efficiency as applicable.

NOTE: Statements of operations and profit and loss are not required.

## A SOLUTION

### THE U MANUFACTURING CO. LTD.

### Analysis of Variances from Standard and Budget

**for the month of September, 1953**

**Sales**

Volume (net)

| | |
|---|---|
| Selling price of 1,600 units instead of 1,500 @ $150 | $15,000 |
| Cost of 1,600 units instead of 1,500 sold @ $110 | 11,00C |

| | | |
|---|---|---|
| | Favourable | $ 4,000 |
| Price | | |
| 1,600 units @ $140 instead of $150 | Unfavourable | 16,000 |

**Material**

| | | |
|---|---|---|
| Price 32,500 lbs. @ 5c | Unfavourable | $ 1,625 |
| Usage 500 lbs. @ $2.00 | Unfavourable | 1,000 |
| | Unfavourable | $ 2,625 |

| **Actual Usage** | | **Standard Usage** | |
|---|---|---|---|
| Opening Inventory | 8,000 lbs. | Closing Inventory | 150 units |
| Purchases | 32,500 lbs. | Production | 1,650 units |
| | 40,500 lbs. | | 1,800 units |
| Closing | 6,000 lbs. | Opening Inventory | 100 units |
| Actual usage | 34,500 lbs. | Equivalent Prod'n. | 1,700 units |
| | | Standard usage | 34,000 lbs. |

**Labour**

| | | |
|---|---|---|
| Price — 34,700 hrs. @ 5c | Favourable | $1,735 |
| Efficiency (33,600 — 34,700) x 1.25 | Unfavourable | 1,375 |
| | Favourable | $ 360 |

Standard hours of production

| | |
|---|---|
| Closing inventory | 80 units |
| Production | 1,650 units |
| | 1,730 units |
| Opening inventory | 50 units |
| | 1,680 units |
| i.e. 1,680 x 20 | 33,600 hours |

Factory Service

| | | |
|---|---|---|
| Price | | |
| Actual hours at actual rate | $78,735 | |
| Actual hours at standard rate | 78,075 | |
| | Unfavourable | $ 660 |
| Efficiency | | |
| Actual hours at standard rate | $78,075 | |
| Standard hours at standard rate | 75,600 | |
| | Unfavourable | $2,475 |
| | Net Unfavourable | $3,135 |

## PROBLEM 3

### Final Examination, October 1953

*Accounting II, Question 1 (18 marks)*

The following information relates to the M Co. Ltd.

(a) Profit for the year ended 31 Dec 1952, as per financial statements before providing for income taxes was $200,000.

(b) The company started business on 2 Jan 1951 and for the year ended 31 Dec 1951 had a net loss, as agreed with the tax authorities for tax purposes, of $25,000 after deducting dividends of $10,000 received during the year from other taxable Canadian corporations.

(c) Dividends of $30,000 were received in 1952 from taxable Canadian corporations.

(d) The allowance for bad debts as at 31 Dec 1951 was $10,000. Of this amount, it was determined by discussion with the tax authorities that $3,000 would be disallowed on assessment of the year 1951. During 1952 the company increased the allowance to $12,000, and it is felt that $11,000 of this allowance will be permitted on assessment because it can now be fully justified.

(e) Charitable donations made in 1952 were $15,000 and political contributions were $2,000.

(f) Legal fees for 1952 were $4,000 including $1,000 for services in connection with a prospectus.

(g) Bond premium on the company's own bonds which was amortized and credited to profit and loss during the year 1952 was $1,500.

(h) Premium received in 1952 on the redemption of preferred shares held as investments by the company was $6,000 and was credited to profit and loss.

(i) Premiums expense for 1952 for life insurance on officers was $1,200 and group insurance on employees was $800.

(j) Interest expense during 1952 totalled $1,400, made up of interest on current bank loan, $1,100, and interest on bank loan used to buy shares in another Canadian company, $300.

(k) During 1951 a reserve for picnics of $500 was set up but it was determined that it would be disallowed on assessment of the 1951 return. During 1952 charges to the reserve for actual expenditures made were $300.

(l) In 1952 a cash defalcation of $500 was made by an employee, of which $400 was recovered through insurance. The net loss was charged to profit and loss account.

(m) Premium paid in 1952 for current service pensions was $8,000, including $1,100 as the employers' contribution to the pension for the general manager.

**Required**

Prepare a statement reconciling the profit per financial statements with taxable income as defined by the Income Tax Act for the year ended 31 Dec 1952.

## A SOLUTION

### M CO. LTD.

### STATEMENT RECONCILING PROFIT PER FINANCIAL STATEMENTS WITH TAXABLE INCOME

**for the year ended 31 Dec 1952**

| | | |
|---|---|---|
| Profit per financial statements before provision for taxes | | $200,000 |
| *Add* | | |
| Bad debts over provided | $ 1,000 | |
| Charitable donations | 15,000 | |
| Political donations | 2,000 | |
| Legal fees re capital | 1,000 | |
| Life insurance | 1,200 | |
| Bank interest re capital investment | 300 | |
| Employer's contributions of pension fund | 200 | 20,700 |
| | | $220,700 |
| *Deduct* | | |
| Bad debts provision disallowed 1951 | $ 3,000 | |
| Dividends received | 30,000 | |
| Bond premium | 1,500 | |
| Picnics expense | 300 | |
| Donations — 5% of $215,900 | 10,795 | $ 45,595 |
| | | $175,105 |
| *Deduct* 1951 loss carried forward | | 35,000 |
| Taxable income | | $140,105 |

| | | |
|---|---|---|
| Calculations of donations allowed | | |
| Net profit | | $200,000 |
| *Add* — as above | | 20,700 |
| | | $220,700 |
| *Deduct* | | |
| Bad debts | $3,000 | |
| Bond premium | 1,500 | |
| Picnics expense | 300 | 4,800 |
| | | $215,900 |

## *EXAMINER'S COMMENTS*

Common misinterpretations by candidates were as follows:

1. The premium on redemption of shares, $6,000, was considered non-taxable.
2. The bad debt adjustment was calculated correctly but the reserve from 1951 of $4,000 was deducted from the $25,000 loss.
3. The 1951 dividend of $10,000 was not added to the loss carried forward.
4. The donation allowance was calculated on the wrong profit.

# THE TAX REVIEW

*Melville Pierce, B.A., LL.B., Editor*

[1954] JUNE Part I

## RECENT TAX CASES

### M.N.R. v. Robertson

*(Exchequer Court of Canada, Potter J., April 12, 1954)*

**Chief Source of Income — Farming loss — Chief occupation distinguished from chief source of income — Minister's discretion — Review of — ITA (1949) s. 13**

**Appeals — Appeal by Crown from ITAB — Onus on taxpayer**

In 1948 respondent purchased a farm of 300 acres in Ontario and purchased 100 more acres the following year. The land was in a very dirty condition and in the first year about 200 acres were cleared, with the result that in 1949 she sustained an operating loss of $7,860 on her farming operations in addition to $4,842.97 depreciation on her farm equipment. In that year she derived income of $12,223 from securities, and in reporting her income for income tax purposes claimed to offset her farming loss (including the depreciation) against her other income. The Minister, however, exercising the powers conferred on him by ITA s. 13(3), ruled that her chief source of income was neither farming nor a combination of farming and some other source of income within the meaning of s. 13(3), with the result that only 50% of her farm operating loss (i.e. exclusive of depreciation on her farm equipment) was deducted from her other income. Respondent's appeal to the ITAB was allowed by Mr. Fordham (*sub nom 76* v. *MNR* [1953] Tax Rev. 55) on the ground that farming was respondent's *bona fide* occupation and not a hobby. The Minister appealed to the Exchequer Court of Canada.

*Held,* reversing the Court below, inasmuch as respondent's farming operations produced no income whatever the Minister could not rule that her chief source of income was farming or a combination of farming and some other source.

*Held* also, an appeal to the Exchequer Court from a decision of the ITAB is a trial *de novo* whether the appeal be by the taxpayer or the Minister, and the onus of proof is therefore upon the taxpayer in either case. *MNR* v. *Simpson's Ltd.* [1953] Ex. C.R. 93, per Thorson P., followed.

*Minister's appeal allowed*

## Geo. T. Davie & Sons Ltd. v. M.N.R.

*(Exchequer Court of Canada, Cameron J., March 27, 1954)*

**Business Profits — Profit of Year — Shipbuilding contract — Reduction of amount due on loan by Crown company — Abatement of indebtedness not a trading profit of year — Abatement of loan not a subsidy — Benefit not a profit from shipbuilding business**

Appellant company entered into contracts in 1946 and 1947 to construct five vessels at a fixed price per vessel for a Chinese company. The Chinese company borrowed money from Canadian banks to finance the construction of the ships and the repayment of those loans was guaranteed by the Government of China, and the undertaking of the Chinese government was guaranteed by the Government of Canada under the authority of Part II of the Export Credits Insurance Act (1944-45, c. 39). By August 1948 appellant was in such financial difficulties due to increased costs and certain technical difficulties that it was unable to fulfill its contract, and in September 1948 it executed a mortgage of all its immoveable property to the Canadian Commercial Corporation (a Crown company) to secure the payment of advances previously made and to guarantee further advances which the Canadian Commercial Corporation might make. Appellant's loss on the shipbuilding contracts, which were completed in 1949, was $1,150,164 and its indebtedness to the Canadian Commercial Corporation was $914,000. The Chinese company thereafter paid an additional sum of $284,813 on account of the contract price of three of the vessels, which appellant treated as a trading receipt and used to reduce its indebtedness to the Canadian Commercial Corporation. In the same year Parliament appropriated $850,000 to reimburse the Canadian Commercial Corporation in respect of the losses it might sustain on its advances to appellant, and in November 1949 the Government of Canada agreed to abate $450,000 of the amount due by the appellant on advances made to it in respect of the losses sustained on the shipbuilding contract, and the agreement was effectuated by reducing appellant's indebtedness to Canadian Commercial Corporation by $450,000. In its own accounts appellant treated this sum as an increase in its capital surplus. In assessing appellant to income tax for 1949 the Minister of National Revenue added the amount by which appellant's indebtedness was reduced, *viz* $450,000, to the income reported by appellant. Appellant's appeal to the ITAB was dismissed (per Messrs. Monet and Fordham, Mr. Fisher dissenting), and it appealed to the Exchequer Court of Canada.

*Held,* the abatement of appellant's indebtedness was not a subsidy but an abatement of a debt of capital, and the cancellation or abatement of a debt, whether it be a trading debt or a debt of capital, in a year subsequent to that in which the debt arose does not give rise to taxable income in the hands of the taxpayer whose debt is cancelled or abated. Appellant company did not receive payment of the $450,000 in 1949 nor acquire any right to receive it in that year. The reduction of its liability was purely an act of grace coupled possibly with matters of public policy and business motives, and the benefit received by appellant from the abatement was not a profit from its business. *British Mexican Petroleum Co.* v. *Jackson,* 16 T.C. 570, followed and applied.

*Appeal allowed*

## M.N.R. v. J. T. Labadie Ltd.

*(Exchequer Court of Canada, Potter J., March 27, 1954)*

**Business Profit — Auto sales company — Sale of cars used for business purposes — Intention to sell after temporary use — Whether profit a business profit or capital gain**

Appellant company carried on a large garage and auto sales business in Windsor, Ontario, where it had two garages and two used car lots, and it also had four associate dealers in Essex County whom it supervised. For the purpose of its business it required a number of passenger cars for the use of its officers and employees, and in 1949 it sold 12 such passenger cars which had been used for that purpose for $6,997 more than the amount at which the cars were carried on its books after depreciation. Eight of the cars had been purchased wholesale in 1948 and four in 1949. Those purchased in 1948 were shown as depreciable capital assets in appellant's 1948 return and depreciation allowances claimed and allowed in respect of them, but in assessing the company for 1949 the said $6,997 was added to appellant's reported income. Appellant's appeal to the ITAB was allowed [1952] Tax Rev. 67, and the Minister appealed to the Exchequer Court of Canada. At the hearing the president of the company who was the controlling shareholder gave evidence indicating that the intention of the company was to use the cars in the company's business until they had been driven about 6,000 miles and then replace them with others, i.e. before they were worn out. The cars were sold in the ordinary course of the company's business, commissions being paid to salesmen on the sales. In the company's books the cars were shown as capital assets.

*Held,* on the evidence it must be found that it was not the company's intention to appropriate the cars in question to plant, i.e. to capital, and that it did not actually deal with them as capital assets, and as they were dealt with, that is purchased and sold, as cars ordinarily carried as stock-in-trade, although temporarily used for the company's purposes, it follows that notwithstanding the method of bookkeeping used, and notwithstanding that they were shown as fixed assets in the company's tax returns, their purchase and sale was really the carrying on of part of its business which it was authorized by its letters patent to carry on, *viz* "to buy, sell, etc. and generally deal in all kinds of automobiles", and that the profit on the sales was income from its business within the meaning of ITA 1952 secs. 3 and 139(1)(e).

*Minister's appeal allowed*

# INCOME TAX APPEAL BOARD CASES

*Fabio Monet Esq., Q.C. (Chairman) Cecil L. Snyder Esq., Q.C., (Assistant Chairman) W. S. Fisher Esq., Q.C. and R. S. W. Fordham Esq., Q.C.*

## Cadieux v. M.N.R.

*Capital Gain or Income — Intention not sole factor — Purchase of property without intention of selling — Course of conduct in disposing of property — A trading venture or profit-making scheme — Cash or accrual method of computing profit — IWTA (1946)*

In 1945 Cadieux, who owned a summer residence at Lac L'Achigan in Que-

bec, purchased an adjoining farm with the intention of using it to raise poultry, but finding that it was unsuitable either for that purpose or for cultivation, bought an adjoining property fronting on the lake, converted a house thereon to a hotel, built a dance hall, subdivided the two farms into lots, gave part of the land to the municipality to construct a road running along the rear of the lake front properties, built three cottages, which he rented for a time and then sold, and sold sixteen lots during the years 1946, 1947, 1948, 1949, and 1950. He was assessed to tax on the profits therefrom.

*Held* (Mr. Monet), notwithstanding that it may have been appellant's intention to farm the land which he bought at the time that he bought it, the profits were not capital profits but profits of a venture in the nature of trade and so assessable to tax. In addition to considering his intention at the time of purchase his whole course of conduct must be examined and the method used by appellant in disposing of the farms amounted to a venture in the nature of trade or to a scheme for profit-making.

*Held* also, appellant having expressed the desire that his profits, if assessable, should be computed for tax purposes by the so-called cash basis rather than by the accrual method adopted by the Minister, the matter should be referred back to the Minister to take appellant's expressed wish into consideration in assessing him for the years under review. Although there is no provision in the IWTA similar to s. 14 of ITA 1948 in relation to the methods of computing income from a business, the spirit of the IWTA is the same on the matter of the cash and accrual methods.

*Que, Jan 25/54* *Dismissed*

### Taylor v. M.N.R.

*Capital Gain or Income—Isolated transaction—Company manager buying material and selling it to company—No intention to make profit—Not adventure in nature of trade*

Taylor was general manager of a group of Canadian companies which were engaged in the business of manufacturing and fabricating metals including lead. It was an inflexible rule of the company that lead could only be purchased as and when required for manufacturing purposes and that it could not be purchased on the futures market. Taylor, whose life's work was bound up with the companies and their interests and who looked upon them as his own, saw an opportunity to acquire a supply of foreign lead at a price no greater than the price for Canadian lead, and as there were sometimes difficulties in acquiring Canadian lead he sought permission for one of his companies to buy the foreign lead in order that it might be on hand when required to manufacture for certain foreign orders. His proposal was, however, not approved, but permission was granted for him to purchase a quantiy of 1500 tons of foreign lead on his own account and sell it to the Canadian companies at the market price for Canadian lead which should prevail at the time of the subsequent sale. Taylor made the purchase of the foreign lead and almost on the same day sold it to one of the Canadian companies at the current Canadian price, which was greater than the price at which he bought it. He was assessed to income tax in respect of that profit. This was the first occasion on which he executed such a transaction.

*Held* (Mr. Fisher), Taylor did not enter into the transaction with the hope and expectation of making a profit but for the primary purpose of ensuring a supply of lead for his companies, at a time when it was in short supply, in order to enable the companies to enter into certain contracts. The transaction was not an adventure in the nature of trade

but an isolated transaction entered into without the intention of making a profit in any event out of the transaction, and therefore the profit was in the nature of a capital profit rather than one of an income nature. *Leeming* v. *Jones* [1930] 1 K.B. 279, per Lawrence L.J. at p. 302, approved.

*Ont, Dec 16/53* *Allowed*

### Portney v. M.N.R.

*Income from Business or Capital Gain — Series of purchases and resales of houses over 8 years — Intention to increase investment income*

Portney, who conducted an embroidery business, commenced to buy, exchange and sell houses in 1942, employing a real estate agent in his transactions and occasionally executing minor repairs to some of the houses. Between 1942 and 1948 he purchased 26 houses and sold or exchanged 22, at the end of 1948 owning seven houses valued at $50,000, and in that year his rental income before depreciation was $3,277. By the end of 1952 he had made 5 additional purchases and one sale, and the value of the houses he then owned was $60,000, and his rental income in that year was $4,148. His profit on the sales of houses from 1942 to 1951 was $23,000, and he owned 9 houses which he had decided to retain. In no year between 1942 and 1951 did he purchase less than one house, and often more. The Minister assessed Portney to income tax in 1949 in respect of the profit made by him on the sale of two houses bought and then sold in that year. Portney testified that his intention in selling any of the properties was to increase his investment income and not to carry on a business scheme for making profit.

*Held* (Mr. Fordham), the gain in question was income from a business carried on by Portney. A total of 26 purchases and 22 sales in 8 years was far from normal and was inconsistent with the contention that Portney was not conducting a profit-making scheme. Moreover, his course was not always one of buying and holding, but largely of buying and re-selling. *Byrk* v. *MNR* [1951] Tax Rev. 204 (ITAB) distinguished by reason of the number and frequency of Portney's real estate transactions during the 8 years in question.

*Man, Dec 16/53* *Dismissed*

### 154 v. M.N.R.

*Income or Capital Gain — Arranging purchase and resale of shares for fee — Reward for service rendered is income*

The president of appellant company, which carried on business as management consultants, learned in the course of carrying on appellant's business that the shares of a client company, which was in the building supply business, could be purchased from their holders at a good price on the retirement of that company's president, and he knew another client who would be interested in purchasing either the shares of that company or its plant. While appellant company had the power to carry out a transaction of that kind it was not equipped to do so, according to its president, but the Y company was in his opinion equipped to do so and on a resolution of appellant company's directors it was agreed to offer the information so obtained by appellant's president to the Y company for a fee of $5000 or a one-third share of the gross profits which the Y company might realize on the transaction. Some 95% of the shares of both appellant company and the Y company were held in the same proportions by the same 4 persons including appellant's president. At a meeting of the Y company's directors on the same day the offer of appellant company was accepted, whereupon the Y company pur-

chased the shares of the building supply company, appellant's president supplied the Y company with the name of the prospective purchaser of these shares and sat in at the first meeting between the prospective purchaser and the president of the Y company. The president of the Y company carried on subsequent negotiations alone and eventually effected a sale of the shares at a good profit. Appellant company received $10,000 in 1950 pursuant to its agreement with the Y company, upon which amount it was assessed to income tax.

*Held* (Mr. Fisher), the amount in question was received by appellant for a service rendered by it to the Y company and this constituted income in its hands. *Ryall* v. *Hoare,* 8 T.C. 521, per Rowlatt J. at 525; *I. T. Case 319,* 8 S.A.T.C. 176, applied.

*Mar 3/54* *Dismissed*

### 145 v. M.N.R.

*Income or Capital Gain—Building development company—Parcel of land acquired for development as shopping centre — Unsuitability for that purpose — Sale at profit*

Appellant company was a real estate development company engaged in the development of a certain area, building houses and selling them. In 1950 it acquired a certain parcel of land with the intention, as disclosed by the evidence of its treasurer, of developing it as a commercial site to serve the adjoining housing development. However, the site became unsuitable for this purpose when a street was constructed through it and, moreover, owing to the unexpected growth of the adjoining housing development it was regarded as too small for what was needed. In these circumstances appellant sold the site, making a profit.

*Held* (Mr. Monet), the parcel of land was an asset in which appellant had invested with a view to erecting commercial buildings thereon, and the profit made on its sale was therefore of a capital nature.

*Feb 4/54* *Allowed*

### Pearson v. M.N.R.

*Income or Capital Gains — Purchase of farm — Registration of plan — Subdivision into lots — Sale of lots — Intention of vendor*

*Cash or Accrual Method of Reporting Income — Right of taxpayer to choose initial method*

In 1945 Grosskurth, a retired merchant, called the attention of Pearson, a retired builder, to a farm of 30 acres near Weston, Ontario, where both men lived, which land could be purchased at the favourable price of $275 an acre. The two men contributed equally to the purchase of the land, which was at that time rented to a farmer. Their principal reason for purchasing the land was that it was situated in a rapidly expanding district and they hoped to make a gain on its disposal. There was no ready sale for the farm in one parcel, and it could not be rented for an amount sufficient to cover the carrying charges, and so in the fall of 1947 they decided to sell a portion of the land. They then discovered that the Ontario Planning Act prevented the sale of the land unless certain improvements were made and a plan of subdivision registered. They accordingly carried out the necessary improvements at a cost of $4,000 and registered a plan, subdividing the farm into 82 lots, put up "For Sale" signs, and sold all the lots. Pearson appealed from income tax assessments assessing him to tax in respect of his profits on the sale of the lots in the amount of $2,053 for 1948, $780 for 1949, and $1,217 for 1950.

*Held* (Mr. Snyder, Mr. Monet concurring), having in mind Pearson's original

intention in acquiring this property and the manner in which the land was subsequently disposed of by the sale of individual lots, it must be held that he was engaged in carrying on a business or activity or an adventure or concern in the nature of trade for the obvious purpose of making a profit, and that such profit was income to him within the meaning of ITA 1948 s. 3(1) and the equivalent section of the IWTA. *Lapp* v. *M.N.R.* [1951] Tax Rev. 50 distinguished; *Rutledge* v. *C.I.R.*, 14 T.C. 490, applied.

*Held* also, the assessments should be remitted to the Minister to reassess Pearson taking into consideration his expressed wish to be assessed on a cash basis rather than on the accrual basis adopted by the Minister in making the assessments appealed against. *Cadieux* v. *M.N.R.* [1954] 1 Tax Rev. 397 followed.

*Ont, Mar 15/54* *Allowed in part*

### Pepper v. M.N.R.

*Employment — Musician employed by orchestra leaders — Private engagement as orchestra leader — Automobile expenses — Deductibility of*

Pepper, who was both an optometrist and a musician, derived income in 1951 by way of remuneration for playing his instrument for four different orchestra leaders, from two separate engagements as a musician by the Canadian Broadcasting Corporation, one running for approximately 39 weeks and the other for 10 or 12 weeks, and also from two private engagements as leader of an orchestra provided by him to furnish music for dances, and also from arranging music. In his income tax return for 1951 he claimed a deduction against the above income in respect of certain automobile expenses and also a capital cost allowance on his car. The Minister disallowed the deductions on the ground that appellant's income was derived from an office or employment.

*Held* (Mr. Fisher), appellant's income received through the Canadian Broadcasting Corporation and from the four orchestra leaders was income received from *employments* but the other income mentioned was derived by him as an independent contractor and not through an office or employment, and accordingly he was entitled to a deduction against the latter amounts in respect of his car expenses and the capital cost of his car if the car was used in connexion with the earning of that income.

*B.C., Feb 4/54* *Allowed*

### 149 v. M.N.R.

*Employment — Deductions — Employee remunerated by share of employer's profits — Not a commission — No deduction allowed for expenses — ITA 1948 s. 11(6)(c)*

The vice-president of a textile manufacturing company, who had charge of its sales, was remunerated by salary and a percentage of the company's net profits. In 1951 he claimed a deduction for his car expenses, Christmas gifts, and entertainment expenses in computing his income from his employment.

*Held* (Mr. Fordham), a percentage of an employer's net profit is not a commission or percentage of sales, and hence ITA s. 11(6)(c) does not apply to permit the deduction of the amounts claimed.

*Que, Feb 19/54* *Dismissed*

### Raber v. M.N.R.

*Employment — Commission Agent — Entertainment expense — Absence of vouchers — Whether made to acquire goodwill — Capital expenditure*

Raber, a registered broker's agent working with a brokerage firm on com-

mission, was disallowed a deduction of $1,925, the amount which he estimated that he spent in 1951 in entertaining clients or possible clients, in purchasing meals, drinks, tickets for sports events and the theatre, and gifts. He appealed from the disallowance of the deduction, but produced no vouchers or itemized record in proof of the expenditures and he asserted that when giving tickets to a client or prospective client he always hoped that it would lead to introductions to other potential clients.

*Held* (Mr. Fisher), the evidence was not sufficient to meet the onus on appellant of showing that the assessment was incorrect or that the expenditures claimed by him were allowable. To some extent the expenditures claimed to be made could well be considered to have been made for the purpose of enlarging the field of his potential clients and obtaining their confidence, and that was a form of expenditure for obtaining goodwill and therefore a payment in respect of capital, the deduction of which is prohibited by ITA s. 12(1)(b).

*Ont, Mar 12/54* *Dismissed*

McLeavy v. M.N.R.

*Employment — Deductions — Cost of small tools used — Whether "consumed" — ITA (1952) s. 11(10)(c)*

An aircraft maintenance engineer employed by an aircraft repair company and required by the terms of his employment to supply his own small tools for use in the performance of his duties spent $229 in 1952 in purchasing new tools and replacing others which had become broken, lost, or worn-out in the performance of his work.

*Held* (Mr. Fisher), he was not entitled to deduct the cost of tools worn-out, broken, or lost in the performance of the duties of his employment in computing his income from his employment for 1952. Section 11(10)(c), which, by way of exception from s. 5, permits a deduction for the cost of supplies that were consumed directly in the performance of the duties of an employment, does not apply since the tools in question were not "consumed" as distinct from "used" in the course of the employment. The word "consumed" in s. 11(10)(c) means "used up" so as to be unfit for further use in the performance of any similar employment.

*Alta, Feb 19/54* *Dismissed*

# INCOME TAX REGULATIONS

## P.C. 1954-499, April 5, 1954

### Revocation of Regs. 1100(4) and 1700(5)

**HIS EXCELLENCY the Governor General in Council, on the recommendation of the Minister of National Revenue and by virtue of the powers conferred by s. 117 of the Income Tax Act, is pleased to amend the Income Tax Regulations made and established by Order in Council P.C. 6471 of December 22, 1949, as amended, and the said regulations are hereby further amended by revoking therefrom s. 1100(4) and s. 1700(5) thereof, which require capital cost allowance deductions to be reflected in the financial statements of corporations, the said amendments to be applicable to the 1954 and subsequent taxation years.**

*SOR/54-126* *Canada Gazette, April 28, 1954*